

SCIENCE OF PUBLIC FINANCE



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SCIENCE OF PUBLIC FINANCE

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CONTENTS

VOL. II

BOOK III.—PUBLIC REVENUE OR INCOME—*continued*

CHAPTER XXIII

	PAGES
DEATH DUTIES OR INHERITANCE TAXES	521-581
DEATH DUTIES AS A SOURCE OF DIRECT TAXATION—	
Section 1. Inheritance taxation on the occasion of transfer of property on the death of the owner has increased in popularity in the present century and, there are to-day about thirty countries levying a tax on the estate as a whole or on the respective shares of the beneficiaries or on both. The taxation, however, is in reality very old, as it was known in Egypt as early as 700 B.C.	521-524
GENERAL PRINCIPLES: I. INTRODUCTION—	
Section 2. The tax is sound in theory and practice and it is usually classified into two categories: (1) An estate duty levied on the inheritance as a whole; and (2) a succession duty or share tax on the separate portions going to the different beneficiaries. Both classes of taxation have their peculiar characteristics	524-526
II. THE EQUITY OF DEATH DUTIES—	
Section 3. As the State protects the property of the individual it is not unfair that it should come at the death of the owner of the property and take a share in the form of taxation before it is passed on to the beneficiaries. It is the existence of the State that makes the accumulation of private fortunes possible, and it is right that society as a whole should share and share progressively in this, the larger the estate, the larger the share. Death duties are a useful complement to the taxation of income although charged on a different basis as a test of ability. It extends to assets untouched by the income tax. The estate duty takes no account as a rule of the ability to pay of the successor or successors	526-534
III. THE TAXATION OF CAPITAL FALLACY—	
Section 4. One of the most common fallacies in the whole field of public finance is that a tax on capital is bad in principle.	

This ambiguous maxim, " Tax income if you like but never capital : a tax on capital beggars you and checks the accumulation of capital to a far greater extent than does income tax ", is a mistaken belief. It is also a fallacy to say that when taxes are paid out of capital a country is living on its capital instead of on its income. When inheritance duty is paid it is often paid out of the capital of the estate, but the State almost always receives resources obtained by the selling of securities or other form of property which, but for the tax, would have become new capital. Death duties do not destroy existing capital any more than income tax does. The persons buying the estate or the securities may have realised other securities to make the purchase. There will be merely a redistribution of capital. The capital of the country suffers no diminution ; whether the State loses revenue or not depends on the final redistribution among the different classes of income tax and surtax payers. These facts are sometimes overlooked by those who argue that there is evaporation of capital consequent on the levy of death duties. One of the results of the fallacy of assuming that death duties are paid from capital and are not paid out of the national income is that death duties should be earmarked for capital expenditure in the budget especially for debt redemption. There are fallacies underlying this

535-541

IV. THE EFFECTS OF DEATH DUTIES ON SAVING AND ENTERPRISE—

Section 5. Death duties take away from individuals actual capital, but the expenditure by the State may add to the power of accumulation by its inhabitants even more than the amount of capital taken from individuals and, all things considered, as compared with other taxes, death duties are only to a small extent more damaging to saving. If the Government spends the proceeds in paying interest on public debt the tax-paying classes benefit considerably from this transfer of capital. If the expenditure by Government is wasted the realised savings of the nation may be wasted just as if the money had been raised by other taxes such as a tax on investment incomes. No special disadvantage in this respect rests with death duties. Death duties do not interfere with the motives for accumulation. It is sometimes argued that the existence of a death duty will be an incentive to a man to save. There are many countervailing considerations which make it impossible to generalise with accuracy on the ultimate effect of death duties ; but the following five conclusions summarise the effect on saving and enterprise : (1) Estate duty does not make for *saving* as much as does the income tax or equivalent lump sum taxes assessed annually, mainly because it is a deferred tax and drawn from the largest fortunes ; (2) it is less damaging to *enterprise* than the income tax ; (3) a substituted annual tax on income confined to incomes corresponding to the capital on which estate duties are paid and bringing in a revenue similar to that on inheritance taxation at present in force would be more prejudicial to *saving* and *enterprise* than the system of death duties ; (4) a tax on property at stated intervals in place of at death would have a similar effect on *saving* and *enterprise* in the long run as a substituted tax on income ; and (5) especially in times of depression there may be excessive saving and a nation's savings may be

CONTENTS

vii

PAGES

out of all proportion to what they were or ought to be. While death duties do prevent potential new capital from coming into being the issue to be decided is whether this new capital is desirable or not? The answer to this question must be answered in the circumstances of any given year	541-545
V. GRADUATION ACCORDING TO TIME AND THE RIGNANO PLAN—	
Section 6. In the British and the United States inheritance duties the principle of the time element is recognised, as it is in the Rignano plan. Rignano's plan is best described in Rignano's own words, which should not be considered from the point of view of the transfer of wealth to the State but from the point of view of its being a practical instrument for raising revenue. It must be isolated from the socialistic object in view. In support of the tax it is urged that it would stimulate thrift and enterprise, that it conforms to the canon of equity, and being productive it would be useful in redeeming public debt. On the other hand, it is said that the chances of evasion are very great, that it lacks the means of adapting changing values to the values of the estates inherited, that it would take a considerable time before it could come into operation, and that the tax would be costly to collect. On the score of practicability it is unworkable. There are variations of this plan which deserve consideration	545-551
VI. DEATH DUTIES OR INHERITANCE TAXES IN FEDERAL CONSTITUTIONS—	
Section 7. A federal tax should be levied wherever possible and a share of this made over to the State or Provincial Governments. The Federal authority may administer the tax and have the right to place a surcharge for its own purpose when necessary on the proceeds which go to the Units	552-556
VII. DEATH DUTIES IN GREAT BRITAIN—	
Section 8. The history of death duties in Great Britain up to the present time. Estate duties, legacy and succession duties	556-563
VIII. THE DOMINIONS—	
Section 9. The history of these taxes in the Dominions. The feasibility of death duties in India under the laws of inheritance	563-576
IX. THE CROWN COLONIES—	
Section 10. The history of death duties in the Crown Colonies	576-577
X. THE UNITED STATES—	
Section 11. Death duties in the United States	577-579
XI. FRANCE AND OTHER COUNTRIES—	
Section 12. Death duties in France and other countries	579-581
CHAPTER XXIV	
OTHER DIRECT TAXES	582-605
Other direct taxes include direct taxes such as poll or capitation taxes; direct consumption taxes such as those on inhabited houses, etc.; and the taxation of surplus.	
POLL OR CAPITATION TAXES—	
Section 1. The history of poll taxes and the question of a graduated poll tax in various countries. The main objections	

	PAGES
to this form of taxation are that they are inconvenient and do not take into account the real ability of the taxpayer	582-587
DIRECT CONSUMPTION TAXES—	
Section 2. Direct consumption taxes in some countries	588-590
THE TAXATION OF SURPLUS—	
Section 3. The taxation of surplus	590-591
THE TAXATION OF CORPORATIONS—	
Section 4. Governments confer certain special privileges or a franchise on a corporation, and by this the corporation possesses certain advantages or privileges. When as a result the earnings of the corporation are in excess of a reasonable return on the amount invested, and when this excess is not attributable to any other cause except its corporate charter, it is only just that corporations should be taxed for the additional privileges they enjoy. It is advisable to classify the taxation of corporations under the taxation of surplus	591-598
EXCESS PROFITS TAXATION—	
Section 5. Another class of taxation of surplus is excess profits taxation or windfall taxation. Criticism of this tax. It has in the past brought considerable revenues to national exchequers. In the future fiscal authorities should impose taxes of this nature when circumstances arise to produce abnormal profits. Theoretically the taxation of windfalls should allow for changes in the price-level, changes in the general rate of interest as well as anticipated increments. Experience has shown that in future it will be well to neglect the allowance for changes in the price-level, interest, etc., and merely to take into the taxation net those increments which are exceptionally large	598-605

CHAPTER XXV

SALES OR TURNOVER TAXES	606-619
Section 1. The rediscovery of sales taxes has been one of the most striking features of post-War fiscal policy as it has been highly successful from the standpoint of revenue. Definition of a sales or turnover tax. Sales taxes in various countries	606-610
SCOPE OF THE TAX—	
Section 2. The tax may be general as in France or Germany. Retail transactions may be excluded as in Belgium. It may be, on the other hand, confined to retail transactions. It may be imposed on the producer or manufacturer or on classified industries and commerce only. It may be levied on nearly all goods and services as in Germany. It may exempt certain sales as in France. The tax is not so difficult to collect or to evade as is sometimes imagined owing to the keeping of books even by small traders, and where books are not kept an estimated tax is workable. National sales taxes are collected usually through the ordinary administrative machinery. The greatest indictment against the sales tax is its encouragement of the integration of industry and its influence in changing methods of business. Another criticism against the tax is that	

CONTENTS

ix

PAGES

it may discriminate to the disadvantage of the poor because it is shifted and becomes a tax on expenditures. Luxury taxes are supplementary to sales taxes. The distribution of the proceeds of sales taxation varies. In some cases it is exclusively national, and in other cases it is shared

610-616

SALES TAXES IN VARIOUS COUNTRIES—

Section 3. The history of sales taxes in various countries: Germany, France, Belgium, Canada, and Australia. The lessons from these countries are : (1) In times of emergency the tax is productive if the administrative machinery can be made available in order to avoid evasion and if the tax is kept within moderate limits ; and (2) the tax should not be regarded as a substitute for the income tax or selected excises, but it is a tax which should be levied side by side with a progressive income tax

616-619

CHAPTER XXVI

CUSTOMS DUTIES

620-651

GENERAL ECONOMIC CONSIDERATIONS—

Section 1. There are general considerations regarding sea and land customs duties which are earlier in origin than excise duties. Export duties were frequently levied on the assumption that the foreigner would pay the tax. They were sometimes imposed in order to prevent exports. Export duties for revenue purposes should be sparingly used and imposed to a moderate degree, and only on those articles in which the taxing country possesses a monopoly or quasi-monopoly. Import duties are increasingly popular. The advantages to home industry, coupled with the convenience and productiveness of the tax tend to make import duties more and more prominent in customs systems. A tax on imports may fall on the consumer in the taxing country when the foreign producer has alternative markets. It is not possible to gain a large revenue from customs duties and at the same time to have protection. "Taxes", says Adam Smith, "proposed with a view to prevent, or even to diminish, importation are evidently as destructive of the revenue of the customs as of the freedom of trade"

620-626

THE IMPORTANCE OF CUSTOMS REVENUE—

Section 2. The importance of customs revenue in the chief industrial countries of the world. Customs revenue is, with rare exceptions, of relatively less importance in the total tax revenue than before the War. These exceptions are, however, of much interest

626-627

THE FORM OF A TARIFF—

Section 3. *Ad valorem* versus specific duties. The reasons for the tendency to specific duties. *Ad valorem* duties are being abandoned in most countries of commercial importance and specific duties are taking their place, as the latter are comparatively easy to collect and from the administrative point of view simple. There is little scope for fraud and evasion as is the case with *ad valorem* duties, the great drawback of which is the difficulty of accurate valuation and this throws a great strain on the appraising staff. Specific duties are defective in that they are

	PAGES
regressive in character since they constitute a heavy burden upon the less valuable goods than upon the more valuable goods of the same class	627-630
MISCELLANEOUS FUNCTIONS—	
Section 4. Miscellaneous functions of the customs authorities include the prevention of the importation of certain articles, the prevention of irregular importation or exportation of certain goods, the preparation of statistics, the collection of revenue and, as in Great Britain, work connected with the enrolment and payment of men for the Royal Naval Reserve, the investigation of claims to exemption from National Health Insurance in certain cases, and also the administration of the Old Age Pensions Acts in Northern Ireland	630-631
CUSTOMS DUTIES IN ENGLAND—	
Section 5. The history of customs duties in England, with special reference to the passing of <i>laissez-faire</i> after the Great War	631-636
THE DOMINIONS—	
Section 6. The history of customs duties in the Dominions	636-641
INDIA—	
Section 7. The history of customs duties in India : (1) Up to the year 1861 ; (2) the free trade period 1862 to the beginning of the War (1915) ; (3) the War and post-Armistice period (1916-1921) ; and (4) the period beginning 1922, the year in which the Indian Fiscal Commission reported, up to the present time	641-645
OTHER COUNTRIES—	
Section 8. Customs duties in other countries such as France, Germany, Italy, the United States, and Japan	645-649
CONCLUSION—	
Section 9. A highly protective tariff cannot be looked to as a bountiful source of revenue, and the practical statesman has to balance the merits of a protective duty as a revenue yielder and the merits or demerits of the duty in keeping out the foreign producer. He has to consider the nature of imports from abroad and the elasticity of demand for his country's exports abroad, and whether the foreign customer is bound to purchase goods or whether other sources of supply are available to him. It is for this reason that the British position of taxing the foreigner is much less strong than it was about a century ago, when foreigners regarded Great Britain as the main source of manufactures made by machinery. Great Britain was then a large consumer of food and raw materials which she obtained in exchange and without much trouble. A country by imposing duties on its exports may obtain a contribution from buyers abroad if the demand for the exports is, as we have seen, highly inelastic. If it is considerable it is a strong argument in favour of continuing export duties. If customs duties are to be regarded from the revenue point of view only they should be imposed on necessities and at as low a rate as possible. As a general rule if levied on a small number of articles they may form a system of productive taxation. The regressiveness of these duties is well known and sometimes as a whole these are in-	

CONTENTS

xi

	PAGES
elastic and unable, like income tax, to meet quickly unusual demands upon the National Exchequer	649-651

CHAPTER XXVII

EXCISES OR INTERNAL TAXES ON CONSUMPTION	652-672
--	---------

Section 1. Excise duties are taxes or duties on home produced goods either in the process of their manufacture or before their sale to consumers, especially on spirits, gasoline or petrol, beverages, sugar and tobacco. They include also certain licences, and as a rule exclude sales or turnover taxes and also Government monopolies. They are not always so elastic as income tax although individual articles such as beer and spirits may yield, in times of necessity, a large revenue. They are, however, elastic only up to a point. The discovery in the post-War period of new sources of taxation has led to a large increase in revenue from excises, notably in regard to gasoline or petrol taxation. The advantage of applying the tax at a later stage of production is that differences in quality can be taken into consideration so that higher rates may be levied on the better qualities. These excises should be levied in accordance with the canon of convenience

652-657

657-660

Section 2. The history of excises in Great Britain
Section 3. The history of excises in some other parts of the British Empire

660-665

Section 4. Excise duties in France. They may be grouped under two heads, those produced under monopoly conditions and those taxed as ordinary excise duties. Tobacco, matches, and gunpowder belong to the former, while sugar, salt, drinks, petroleum, the consumption of benzol and benzene, and other miscellaneous articles come under the latter

666-667

667-668

Section 5. Excise duties in Italy and Germany
Section 6. Excise duties in China where the salt gabelle is the main excise tax

668-669

Section 7. Excise duties in Japan, the chief of which are on liquors, sugar, textile fabrics, and table waters

669-670

Section 8. The system of excise duties, known as octroi, which are taxes collected on various articles brought into districts for consumption from outside, has been universally condemned as it is held to impede the trade between town and country and at the same time these duties impose considerable burdens on urban industries and consumers. Not only do octrois interfere with internal trade but the cost of collection is very high. The system, however, has been retained in some countries as necessity knows no law. They exist in Spain, Portugal, France, and in some towns in Austria and North-Western India. In Belgium, Holland, the United States, and other countries they have been prohibited. The tendency is to suppress them gradually, and for national governments to give grants to local authorities in their place, or to give other sources of revenue from supplements to national taxes, or alternatively to give a share of national taxes. Sometimes both these methods are employed

670-672

CHAPTER XXVIII

OTHER INDIRECT TAXES AND FEES	PAGES
	673-687

SCOPE—

Section 1. In recent years miscellaneous taxes have increased in number and in productivity, and a discovery in one country of a productive indirect tax has led to its adoption in another in a surprisingly short time. The distinction between taxes and fees is important in this connexion	673-674
---	---------

STAMP DUTIES AND FEES—

Sections 2-3. Stamp duties on stocks, shares, debentures, on land and property other than stocks and shares, on cheques and bills of exchange and promissory notes, on receipts, and on companies' share capital are sources of revenue in many countries. The incidence of the tax depends on the object of the transaction which is taxed. Stamp duties have been condemned on the ground that they often fall on the wrong person and are not always capable of being graduated according to ability. They should not be so excessive as to retard business or to cause evasion	674-680
--	---------

TAXATION OF BETTING—

Section 4. Taxation of lotteries and betting	680-684
--	---------

TAXATION OF AMUSEMENTS—

Section 5. The proceeds of taxation from amusements are often classified under excises	684-687
--	---------

CHAPTER XXIX

THE BURDEN OF TAXATION	688-707
------------------------	---------

Section 1. The burden of taxation is important from three points of view : (1) To compare the relative total burden of taxation in the same country at different periods ; (2) to compare the relative burdens of direct and indirect taxation in the same country at the same time and at different times ; and (3) to compare the relative burden of taxation at any period in one country with another. With the improvement of methodology in recent years in the calculation of national income it is now possible to make comparisons which hitherto were impossible. By the burden of taxation is sometimes meant the payment burden of the tax, and sometimes the total or sacrifice burden in which this payment burden is included. The burden of taxation must be analysed with care and its effects on saving and business enterprise analysed	688-690
--	---------

Section 2. The idea of burden arises from the fact that : (1) There is an absence of a <i>quid quo pro</i> ; (2) taxation is compulsory and is therefore felt as a burden ; (3) funds are taken by public authorities which would otherwise have been used for private consumption or private saving ; and (4) with the development of States, taxation has enormously increased. The creation of new work and capital is penalised. The real burden of taxation in its relation to national income has	688-690
---	---------

CONTENTS

	PAGES
received considerable importance in the present century, and the burden of taxation of various countries has been worked out both in regard to direct taxes and indirect taxes	xiii 690-695
THE INCREASE IN TAXATION—	
Section 3. The growth of taxation has been due mainly to three factors : (1) Interest charges on war debts ; (2) the extension of the functions of the State, especially in regard to social services ; and (3) the increase in the general level of prices	695-696
PER CAPITA TAXATION AS AN INDEX OF THE BURDEN OF TAXATION—	
Section 4. <i>Per capita</i> taxation is one method of showing tax burdens, but it has its limits of usefulness	696-698
DISTRIBUTION OF DIRECT AND INDIRECT TAXATION—	
Section 5. Another method is to look to the distribution of direct and indirect taxation. Real burdens cannot be discussed without examining what the taxes are and in what proportion they are a definite burden upon individuals	698
PERCENTAGE OF TAXATION TO NATIONAL INCOME AS AN INDEX OF THE BURDEN OF TAXATION—	
Section 6. Another method is to consider the proportion of the total national income of each country taken in the form of taxation. This gets over some of the difficulties arising from differences of wealth, population, social and economic conditions	699-702
BROAD CONSIDERATIONS AND CONCLUSIONS—	
Section 7. The broad consideration is that the burden of taxation can be measured within a country not merely at any one fixed point of time but also at different periods, and comparisons within limits can be made with various countries. But this requires a very careful handling of statistics. There are difficult problems in the calculation : (1) The amount of tax revenue levied in each country ; (2) the calculation of the proportion of the tax revenue per head of population which the tax revenue bears to the national income ; (3) the nature of governmental expenditure with special reference to its productiveness in each country with which comparison is made ; (4) the relation between national and local finance, and in Federal constitutions between National, State, and local finance ; (5) the social conditions and standard of living in the countries compared ; (6) the comparative distribution of income and of wealth ; (7) the incidence of the various taxes in the tax systems compared in relation to the distribution of income and wealth in the countries compared ; (8) the general nature of the industries of each country with special reference to the relative demand for capital equipment ; (9) the extent to which public utilities are run for profit, <i>i.e.</i> as an addition to taxation, or at a loss, <i>i.e.</i> as a remission of taxation ; and (10) the element of psychology. Tax burdens, in short, depend on many factors	702-707

CHAPTER XXX

NON-TAX REVENUE	708-731
Section 1. Non-tax revenue includes (a) the public domain, and (b) the industrial domain, which in turn includes public	

	PAGES
undertakings. To the former belong lands and forests and to the latter irrigation works, railways, posts and telegraphs, and in countries where state or national banks are in existence also the sphere of state banking. Non-tax revenue varies from a low percentage in Italy and Great Britain to a high percentage in Australia	708-710
Section 2. In modern governments state enterprise and the industrial domain are not a negligible source of revenue	710-712
THE PUBLIC DOMAIN : LAND AND FORESTS—	
Section 3. In the early history of modern States the royal domain was the basis of public revenue	712-715
THE PUBLIC DOMAIN IN COMMERCE AND INDUSTRY—	
Section 4. The public domain in commerce and industry dates back to early times	715
Sections 5-9. The importance of mines, the manufacture of goods by State factories, irrigation, posts and telegraphs, and railways, as sources of revenue. In the present century, especially in regard to posts and telegraphs and railways, these sources are capable of earning considerable revenue. Railway finance is important to the State if the railways are its property	715-731
CHAPTER XXXI	
LOCAL TAXATION	732-767
GROWTH OF LOCAL TAXATION—	
Section 1. The growth of local taxation has been the result of the enormous growth of local self-government in almost every country	732-733
SCOPE OF LOCAL TAXATION—	
Section 2. The services administered by local authorities may be generally grouped under two main heads : (1) National (or onerous) and (2) local (or beneficial). Sometimes this classification is known as obligatory and optional. The principle of benefit rather than ability to pay is as far as possible employed in local services. The sources of local receipts are usually grouped under main heads : (1) Taxes on real property ; (2) taxes on industry and trade ; (3) taxes on imports and exports ; (4) the taxation of special articles ; (5) a special tax on site values ; (6) grants from the national or Central Treasury ; (7) an addition to national or provincial taxes ; (8) a tax on public utilities ; and (9) miscellaneous sources. An analysis of each of these forms brings out interesting variations in countries and useful conclusions. The system of grants-in-aid has in recent years received much consideration by governments and by writers on Public Finance. Percentage, block grants, and a formula underlying the principle of giving grants are discussed. The position of local finance in various countries, notably in Great Britain, Germany, France, Japan, and the United States	734-761
SOME PRINCIPLES OF LOCAL TAXATION—	
Section 3. It is possible to lay down some principles of local taxation in respect of the inequality resulting in various countries. The principle of local taxation has sometimes been	

CONTENTS

xv

PAGES

<p>distinguished from the principle of national taxation on account of the greater importance attached in local taxation to the principle of benefit</p> <p>THE EXECUTIVE IN LOCAL FINANCE—</p> <p>Section 4. A study of the executive in local finance in modern times shows the necessity of a strong executive in view of the growing importance of local finance. In recent years there has been increased centralisation in many countries</p> <p>BOOK IV.—PUBLIC DEBT</p> <p>CHAPTER XXXII</p> <p>THE GENERAL CHARACTERISTICS OF PUBLIC DEBTS</p> <p>THE CLASSIFICATION OF PUBLIC DEBTS—</p> <p>Section 1. The problem of finance by borrowing is far from being a simple problem. The term "public debt" has not always the same meaning, and care must be taken in using the term to see what it actually means. The distinction between "funded" and "floating" debt is not always the same in all countries. It is usual to classify public debts according to the viewpoint under consideration, such as (1) The period or duration of the loan, (2) the method of flotation; (3) the place of flotation; and (4) the purpose for which the debts are contracted. It is also possible to classify states into those which borrow at a low rate of interest; states which borrow at a moderate rate of interest; states borrowing at a high rate of interest; and states borrowing at an excessive rate of interest. The fundamental characteristic of a public debt is that it is contracted between the State as borrower and the private owner of capital as creditor. Forced loans and issues of Government currency notes are not in this view public debt. In fiscal literature, war or inter-governmental debts are frequently not classified as public debt because of the special nature of these debts. Sometimes loans are issued in the form of lottery loans</p> <p>THE GROWTH OF PUBLIC DEBTS—</p> <p>Section 2. The indebtedness of local authorities is supervised and controlled by Governments because Governments are affected by the competition of local authorities in the capital market</p> <p>PUBLIC CREDIT: A PRODUCT OF MODERN TIMES—</p> <p>Section 3. Public credit is a product of modern times and is in marked contrast with hoarding</p> <p>THE ADVANTAGES AND DISADVANTAGES OF PUBLIC CREDIT—</p> <p>Section 4. The advantages and disadvantages of public credit. With the advantages of public credit there are also disadvantages which must be carefully examined. The technique of State borrowing requires emphasis</p> <p>TAXATION VERSUS LOANS—</p> <p>Section 5. Public loans exercise a great influence on a country's national economy and this raises the question of taxation <i>versus</i> loans. The problem of loans <i>versus</i> taxation</p>	<p style="margin-top: 100px;">761-763</p> <p>763-767</p> <p>771-803</p> <p>771-779</p> <p>779-781</p> <p>781-785</p> <p>785-789</p>
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raises the question whether the loans are external or internal, and of the shifting of the burden to future generations by the resort to loans. Reliance on taxation avoids the dangers of some of the inflation resulting from credit, especially bank credit

PAGES

789-794

FINANCE BY BANK CREDIT : INFLATION—

Section 6. Finance by bank credit leads to inflation, and the history of the post-War period is especially rich in illustrations of this

794-798

FLOTATION OF LOANS—

Section 7. There are some five methods of raising funds otherwise than by taxation. These are (1) By temporary loans from individuals or from banks ; (2) by permanent or long period loans ; (3) by the issue of inconvertible paper ; (4) by the sales of Government property ; and (5) by utilising hoards of treasure. In the flotation of loans there are one or two principles which may be laid down. Forced loans, if the country is a highly developed one, may be justified in an emergency

798-803

CHAPTER XXXIII**THE BURDEN OF PUBLIC DEBTS**

804-820

In calculating the burden of public debts the nature of the debt has to be carefully considered. The level of prices when the debt is floated is also of importance. In measuring the burden of the debt at different times or in various countries at the same time a knowledge of the national income or of the national wealth is required. Statistics of *per capita* data are apt to be misleading, especially where the standard of living in the countries compared varies greatly. Changes in population, wealth, public assets available for liquidation have also to be considered in comparing one year with another and one country with another. If the loans in one country are the same as in another country but have been floated considerably below par in the former country and in the other country at par, the real burden of debt in the case of the former is much higher than in the latter. Sometimes the proportion of the expenditure for the debt service in relation to the annual budget and also the percentage yield of bonds are taken as an index of the burden. There are other methods. But a combination of methods is essential before definite conclusions can be made in regard to the relative burden. Productive and unproductive debts require examination. The question also arises whether public debts should be included in the valuation of national wealth

804-820

CHAPTER XXXIV**POLITICAL DEBTS AND REPARATIONS**

821-848

THE NATURE OF INTER-GOVERNMENTAL DEBTS—

Section 1. Inter-governmental debts are a very special form of loan, a loan from one Government to another usually with an implied advantage to the lending country. Political loans in peace-time, are, as a rule, small in amount and do not have the repercussions of large war loans and are usually for financial

CONTENTS

xvii

	PAGES
reconstruction. The difference between war debts and commercial debts is of importance. Economic and financial consequences are also discussed	821-828
Section 2. War loans <i>versus</i> subsidies in times of war	828-833
WAR INDEMNITIES AND REPARATIONS—	
Section 3. The history of these indemnities is instructive. Reparations are closely connected with war debts, although from the purely legal point of view this may not always be clear. The history of reparations makes it possible to draw certain conclusions. The Reparation Commission of the Treaty of Versailles, 1919, the Dawes Plan, 1923, and the Young Plan, 1929. The history of reparations is of value from four points of view : (1) The burden of reparations ; (2) the importance of estimating the taxable capacity of the paying nation . (3) the important problem of transfer ; and (4) the dangers of inflation	834-848

CHAPTER XXXV

THE REPAYMENT OF PUBLIC DEBT	849-880
---	---------

Section 1. Some general principles underlying the repayment of public debt. The advantages of debt redemption are : (1) The maintenance and strengthening of national credit ; (2) borrowing with less difficulty when a national emergency arises ; (3) the avoidance of the increased burden of the debt service when the general level of prices falls ; and (4) the setting free by debt redemption of a larger volume of credit than otherwise would be possible for trade and other purposes. The usual method of paying off debt is by the application of a surplus revenue which may be obtained by arranging for a fixed amount of revenue in the Budget. When this is obtained the stock of bonds may be purchased in the open market and redeemed, or the amount provided for may be put to a cumulative sinking fund to "sink" the debt. There are two other regular methods, redemption by terminal annuities and redemption by conversions. There are unusual methods such as : (1) Repudiation, including partial repudiation ; (2) special differential taxation to pay off debt ; and (3) a levy on capital	849-854
--	---------

SINKING FUNDS—

Section 2. The history of sinking funds in various countries is of importance. The fallacy underlying Pitt's Sinking Fund of 1786 must be examined. There are various methods by which the sinking fund method of retiring public debt may be used, such as the cumulative principle, the attachment of special revenues, the payment of a definite sum yearly, the payment of an annual Budget surplus, and sometimes more than one method is combined in a single budgetary system	854-859
--	---------

CONVERSION OF PUBLIC DEBT—

Section 3. Conversions must be sufficiently advantageous to be converted or the holders of the loan will ask for redemption. The history of conversions in Great Britain	859-862
--	---------

REPUTIDATION—

Section 4. Repudiation may be complete or partial, and should be distinguished from default which simply means an
---	-----------

	PAGES
inability to carry out the terms of the contract without denying the liability	862-864
THE CAPITAL LEVY—	
Section 5. The growth in public debt and the resulting large demands in the form of interest make the question of repayment of public debts, especially after a great war, an urgent one. The feasibility of a capital levy is not denied by its strongest opponents, but the moment of such a levy being possible is usually allowed to slip. The levy for economic ills has been tried in several countries and the experience of these countries is of value, although care must be taken to examine the exact conditions so that no false comparisons are made. The objections to a capital levy are its effect on capital and credit. There is really no difficulty in a country like England from the viewpoint of administrative technique	864-878

BORROWING BY LOCAL AUTHORITIES—

Section 6. Borrowing by local authorities raises interesting problems in the repayment of public debt. The various methods of raising such loans are analysed and compared, viz.: (1) By means of a sinking fund ; (2) the annuity method of repayment by equal instalments or principal and interest each year ; and (3) the fixed instalment method which is to repay out of annual revenue the principal by equal instalments for the entire period of the loan, interest being paid on the decreasing balance. Borrowing by local authorities must be controlled in all countries by higher authorities in order to avoid waste and extravagance	878-880
--	---------

CHAPTER XXXVI

THE HISTORY OF PUBLIC DEBT—GREAT BRITAIN	881-906
SCOPE—	
Section 1. The history of public debts in various countries illustrates the principles enunciated in the former chapters, and in addition is of value as showing the differences in the structure of public debt of countries	881-882
THE BRITISH PUBLIC DEBT—	
Section 2. Its history from the post-Revolution year 1689 to the present time. Funded, unfunded, and lottery loans	882-885
THE SINKING FUNDS—	
Section 3. The sinking funds and the chief changes brought about in these funds	885-892
HAMILTON'S MAXIMS OF FINANCE—	
Section 4. Hamilton's maxims of public debt	892-895
CONVERSIONS—	
Section 5. The history of conversions of English public debt	895-900
WAR-TIME FINANCE—	
Section 6. The history of English war debt. The special features regarding loans raised during the War	900-906

CONTENTS

xix

CHAPTER XXXVII

	PAGES
THE PUBLIC DEBT IN OTHER COUNTRIES	907-933
UNITED STATES OF AMERICA—	
Section 1. The history of the public debt in the United States from 1790 to the present time	907-913
FRANCE—	
Section 2. The history of the French public debt, with special reference to its history during the Great War and the post-War period	913-923
GERMANY—	
Section 3. The history of Germany's public debt. The effect of inflation on the lightening of the debt burden	923-925
JAPAN—	
Section 4. The history of Japan's public debt	925-927
INDIA—	
Section 5. The history of India's public debt, which is of importance because of the fact that only 20 per cent is dead-weight debt	927-930
AUSTRALIA AND NEW ZEALAND—	
Section 6. The large <i>per capita</i> debts of Australia and of New Zealand and the formation of the Loan Council in Australia in 1927. The steps taken by the Commonwealth Government of Australia in the crisis of 1931 are a lesson for the future	930-933

BOOK V.—FINANCIAL ADMINISTRATION

CHAPTER XXXVIII

THE PREPARATION OF THE BUDGET	937-974
Section 1. The scope of the Budget. The Budget is an approved plan of income and expenditure for a fixed period of time, usually a year, a plan which is the very basis of the national finances. Differences between a corporation and a government in the accounting system used are discussed. An early history of English public accounts	937-943
THE EXCHEQUER AND THE TREASURY—	
Section 2. The British Exchequer and the Treasury in modern budget procedure. The history of the Exchequer and of the Treasury to the present day	943-949
THE FINANCE MINISTER AND THE BUDGET—	
Section 3. The duties of the Finance Minister in regard to the Budget	949-950
THE PREPARATION OF THE BUDGET—	
Section 4. The preparation of the Budget in various countries, notably Great Britain, France, Germany, the United States, and India	951-964

	PAGES
THE FISCAL YEAR—	
Section 5. The problem of the fiscal year in the Budget The French system of accounts, <i>par gestion</i> and <i>par exercice</i>	964-968
THE CONTENTS OF THE BUDGET—	
Section 6. How far should the items be gross or net and to what extent should detailed heads be shown ?	968-969
SUPPLEMENTARY BUDGETS AND ESTIMATES—	
Section 7. The advantages and disadvantages of supplementary budgets and supplementary estimates	969-972
EXTRAORDINARY BUDGETS AND EXTRAORDINARY EXPENDITURES—	
Section 8. The serious dangers of Extraordinary Budgets	972-974

CHAPTER XXXIX

THE LEGISLATION OR THE VOTING OF THE BUDGET	975-1015
CONSTITUTIONAL CHANGES AFTER THE WAR—	
Section 1. Notably in the United States and Germany	975-977
PROCEDURE IN DIFFERENT COUNTRIES—	
Section 2. The procedure underlying the legalisation of the Budget in different countries, with special reference to Great Britain, the Dominions, India, France, Germany, and the United States	977-1001
INITIATION OF MONEY BILLS BY THE GOVERNMENT—	
Section 3. Initiation of money bills by the Government, a principle of financial administration which has become more and more widespread	1001-1004
Section 4. The annual voting of the whole Budget	1004-1006
THE POWERS OF THE TWO CHAMBERS—	
Section 5. The relative powers of the two chambers under section 4 and their history in various countries, notably Great Britain, Canada, Australia, the United States, and France	1007-1009
REAPPROPRIATIONS AND RESERVE FUNDS—	
Section 6. The Treasury Chest Fund and the Civil Contingencies Fund and their scope and similarity in certain respects	1009-1011
THE VETO AND THE RESTORATION OF DEMANDS FOR GRANTS—	
Section 7. The veto and the restoration of demands for grants	1012-1015

CHAPTER XL

THE EXECUTION OF THE BUDGET	1016-1050
INTRODUCTION—	
Section 1. After the legislation or vote of the Budget adequate machinery is required to secure conformity with the views of the executive and the legislature on it. The manner in which this is carried out in various countries	1016-1023
THE COLLECTION OF REVENUE—	
Section 2. The collection of revenue in various countries	1023-1028

CONTENTS

xxi

PAGES

CUSTODY OF PUBLIC MONEYS—

Section 3. The custody of public moneys in various countries, notably India, England, France, and the United States	1028-1030
Section 4. The method of spending, especially in England and India	1030-1036

ACCOUNTS—

Section 5. Accounts. The importance of accurate accounts in financial administration for affording protection against negligence and fraud	1036-1038
--	-----------

CONTROL OVER ISSUE—

Section 6. Control over issue. This may be divided into : (1) Administrative control ; (2) judicial control ; and (3) legislative control	1038-1045
---	-----------

AUDIT OF ACCOUNTS—

Section 7. The audit of accounts can best be understood by an examination of the history of public accounts in say, England and one or two other countries. Financial administration has been built up after centuries of scientific elaboration, and is a machine worked by perhaps the most upright and highly specialised engineers in the world	1045-1050
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CHAPTER XLI

THE CENTRAL BANK 1051-1068

The importance of the central bank, the pivotal bank of the country in financial administration, and the development of central banking in the twentieth century. The Central Bank is a "great engine of state". The functions of the Government and the Central Bank and the constitution of such a bank. The difference between the New York money market and the London money market. It is the characteristic of a central bank to be independent of the Government but at the same time to be in close touch with it. It is a public trust and not a department of State. The capital of such a bank should be owned by private shareholders. Central Bank functions are limited. These functions are to act as a note-issuing authority, to control credit in the country's interest, and to maintain the stability of the currency. The chief means of managing the monetary system of a country may be similar to that of the Bank of England, which exercises its power through : (1) The official bank rate ; (2) open market transactions ; (3) technical devices ; and (4) through its personal prestige. The difficulties which central banks have to face may be grouped under three heads : viz. (1) Non-monetary causes of disturbance such as political troubles, over-production, changes in tariffs, changes in demand following changes in fashion, rigidity of wages, and other internal economic conditions ; (2) the divergency that sometimes occurs between the interests of the country itself and those of the world outside ; and (3) causes which centre round inadequate control over the monetary machine. The monetary system must be a managed system. An international bank, such as the Bank of International Settlements, is a distinct advance in the idea of central banking

1051-1068

APPENDIX

TABLES

TABLE	PAGES
I. The relative Financial Position of the Chief Countries of the World, 1933-34	1071
II. Revenue, Expenditure, and Debt of the Governments in India (Central and Provincial)	1072-1074
III. Classification of Expenditure—Gross Expenditure of the Governments in India (Central and Provincial) from the Fiscal Year 1861-62	1076-1077
IV. Distribution of Public Expenditure in India among Central, Provincial, and Local Authorities	1078-1079
V. Distribution of Expenditure—Distribution of the Gross Expenditure chargeable against the Revenue of India (Central and Provincial)	1080
VI. Increase in Expenditure—Index Numbers of Gross Expenditure of the Governments in India (Central and Provincial)	1081
VII. <i>Per capita</i> Expenditure, allowing for Price Changes in Various Countries	1082
VIII. The Percentage of Public Expenditure to National Income	1083
IX. Classification of Revenue—Gross Revenue of the United Kingdom	1084
X. Classification of Revenue—Revenue of the Governments in India (Central and Provincial)	1086-1087
XI. Classification of the Revenue of Local Bodies—India. Statement showing the Ordinary Revenue of Municipalities and District and Local Boards in India	1088
XII. Distribution of Revenue—Table showing the Percentage Distribution of the Gross Revenue of the Central and Provincial Governments of India	1089
XIII. The Burden of Taxation—Taxation before and after the War in Various Countries	1090
XIV. The Burden of Taxation— <i>Per capita</i> Taxation before and after the War in Various Countries	1091
XV. The Burden of Taxation— <i>Per capita</i> Taxation in Various Countries, allowing for Prices	1092
XVI. The Burden of Taxation—Taxation and National Income	1094-1095
XVII. The Burden of Taxation—Taxation in India	1096
XVIII. The Burden of Taxation—Direct and Indirect Taxation in Various Countries	1097
XIX. Public Debt by Countries	1098
XX. The Public Debt of India	1100-1101
XXI. Analysis of the Public Debt of Various Countries	1102
XXII. Ratio of Debt to Ordinary Revenue	1103
XXIII. The Burden of Debt—Proportion of Expenditure on Debt Services to Total Ordinary Expenditure	1104
XXIV. Payments due Annually by Great Britain on Account of Debt to the United States	1105
XXV. Cost of the War—Entire Period covering the Six Fiscal Years 1914 to 1919 inclusive	1106
XXVI. National Wealth of the Chief Countries of the World	1107
INDEX	1109

CHAPTER XXIII

DEATH DUTIES OR INHERITANCE TAXES

DEATH DUTIES AS A SOURCE OF DIRECT TAXATION

1. "THE fashion of this world passeth away", wrote the greatest of the Christian apostles, and the truth of this is clearly seen in the change of fashion in regard to taxation at the end of the nineteenth century. States were discovering or rediscovering new sources of revenue, and among these was the second great source of direct taxation—death duties. The number of national governments which levy an inheritance tax on the occasion of the transfer of property on the death of the owner has greatly increased in the present century, and to-day there are about thirty countries levying a tax on the estate as a whole, on respective shares of the beneficiaries, or on both. In federal constitutions, too, the tax has been popular among the Units, as, for example, in the United States, especially since the New York inheritance tax law of 1885 proved successful. The idea was growing that the collection of a tax on the transfer of property from the dead to the living on systematic lines was a means of obtaining a fairly large and regular amount of revenue with the minimum of inconvenience.¹

¹ See (1) *The Taxation of Inheritance*, W. J. Shultz, New York (Houghton, Mifflin Company), 1926. (2) *The Inheritance Tax—a Historical and Economic Comparison between the various Countries*, Max West, New York, Columbia University Press (2nd edition, 1908). This includes all the important countries, the Dominions, and the States of the American Union. (3) *Die Besteuerung der Erbschaften in den wichtigeren europäischen Staaten, mit besonderer Rücksicht auf die schweizerische Finanzreform*, E. Grossman, Berne (Max Diechsel), 1917. (4) *Taxation of Capital*, Soward and Willan, London, Waterlow & Sons, Ltd., 1919. (Contains on pp. 75-81, bibliography of English works, also many footnotes and useful references to Dominion and foreign laws, etc.) (5) Report of the Committee on National Debt and Taxation, London, Cmd. 2800-1927. (6) *Essays in Taxation*, Seligman, New York. (7) *Handwörterbuch der Staatswissenschaften*, vol. iii. Erbschaftssteuer (G. Schanz), Jena, 1928.

It is an occasional tax on property on the death of the owner, *i.e.* levied on an average once in a generation. The tax is found in almost every democratic state as a permanent feature of its revenue system and hardly requires any theoretical justification either from a fiscal or a social point of view. In short, it is a universal fiscal instrument. The reforms in Great Britain fifty years ago have borne much fruit in this respect : In the United States, especially since the 'eighties of the last century, this form of taxation has become so popular that to-day in forty-seven out of forty-eight states of the Union there are inheritance taxes in addition to a Federal tax. In 1916 the Federal Government adopted an estate duty on the estates of resident and non-resident decedents graduated from 1 to 45 per cent with credits for state inheritance taxes paid, not exceeding 80 per cent of the Federal tax and with limitations for gift taxes paid if such gifts were included in the gross estate. The effect of the credit given under the Federal estate duty has been to do away entirely with the burden of state inheritance taxes on states where the rates of the state taxes were below the credit of 80 per cent allowed under the Federal tax and also to increase the number of states levying death duties. The states themselves have increased their taxes in order to take advantage of the maximum credit of the Federal estate duty. This has also had the effect of changing the nature of the tax in the case of many states from a mere tax on beneficiaries to a tax on the whole estate of decedents. Nevada is now the only state without an inheritance duty. The Federal state tax is graduated from 1 to 45 per cent in accordance with the Revenue Act of 1932. Because of the larger credit allowance to cover the state inheritance taxes and because of the large exemption limit (*viz.* \$100,000) the receipts were not more than 3 per cent of the total taxed Federal revenue for 1931-32, while state governments in the same period obtained about 9 per cent of their total taxed revenue from this source. In the self-governing Dominions of Australia, New Zealand, Canada, and South Africa ; in Crown Colonies, such as Ceylon, the Straits Settlements, Hong Kong, the Bahamas, the Barbados, Trinidad and Tobago, Jamaica, the Leeward Islands, British Guiana, the Falkland Islands, Fiji and Sierra Leone ; in other countries such as France, Germany, Holland, Switzerland, Belgium, Italy, Austria, Czechoslovakia, Spain, Norway, Sweden, Denmark,

Chile, Argentina, and Japan there are death duties. Of these Great Britain, the United States, France, Austria, Poland, Finland, Danzig, Chile, and the Dominions of Australia, New Zealand and South Africa have both estate and succession duties. The remainder mainly succession taxes only. India alone of the chief countries of the world does not possess this source of revenue, although it is probable that in the not distant future such taxes must be imposed, as the needs of Provincial Governments for nation-building activities, especially education, are so great.

While the development of death duties or inheritance taxes in recent years is remarkable, it should be remembered that taxation of this kind is in reality very old. In Egypt as early as 700 B.C. there was a 10 per cent tax on the transfer of property by inheritance, and the tax according to a papyrus *circa* 117 B.C. applied to both real and personal property, and no one, not even sons inheriting directly from their father, was exempt from the tax. The Greeks are said to have adopted this form of taxation from the Egyptians. Augustus levied in 6 A.D. a 5 per cent tax, the *vicesima hereditatium et legatorum*, for the payment of the army on those whom he could not reach by the *tributum* or the ordinary property tax, the property tax being leviable only in the provinces. In feudal times estates reverted to the King when there were no rightful heirs, and by the end of the fourteenth century inheritance taxation was to be found in German and Italian cities of commercial importance. In the seventeenth century it was to be found in England, France, Spain, Portugal, and in Holland. North introduced, doubtless from Holland, a stamp duty upon any receipt for any legacy or share or residue of the personal property of a deceased person, a duty increased by Pitt in 1789. In 1796 the property itself was charged, and a tax was imposed on collateral successions at different rates. Successions to land, however, were not taxed till fifty-seven years later. To-day, the estate duty is supplemented by a succession duty on immovable property and by a legacy duty on movable property, both taxes being graduated according to the degree of relationship of the beneficiary with the deceased. As early as 1826 there was an inheritance tax in Pennsylvania. The French inheritance tax dates from 1796 and from 1901 it was progressive. The rate varies according to the total estate whether the decedent is survived by children or no

children, and there are nine classes of heirs with progressive rates of taxation for each. This involves a rate discrimination as in some other European countries, favouring decedents or beneficiaries with large families. Such rates differentiation can hardly be justified in the case of the estates of the decedents, although it can in the case of beneficiaries with large families be justified, as large families do reduce the tax-paying ability of the beneficiary. The Italian law has six classes and was modelled on the French law in 1862. It became progressive in 1902. In recent years the rates of almost all countries have been greatly increased, especially those on the highest incomes in France, where the combined maximum rate of state and inheritance taxes are limited by law to 80 per cent.

GENERAL PRINCIPLES

I. INTRODUCTORY

2. To tax progressively real and personal property on the death of its owner or owners,¹ and also on its acquisition by beneficiaries, exempting to some degree immediate dependants, and increasing the rates in collateral inheritances or bequests to strangers, is sound in theory and in practice. It forms part of any well-arranged scheme of public finance and is usually classified under two categories, an estate tax levied on the inheritance as a whole, and a succession duty or share tax on the separate portions going to the different beneficiaries. Both classes of taxation have their peculiar characteristics. The estate duty or tax is a more productive and efficient source of revenue than the inheritance tax, while the inheritance tax, on the other hand, may be said to be the more equitable. The estate tax is easy to administer, the amount of the tax can be readily calculated and it is a productive tax. It is also held that evasion is less easy under an estate tax than under a succession or inheritance tax, where collusion may take place on the part of the executors of the beneficiaries regarding the relationship of the decedents and the beneficiaries in order that a lower tax rate may be levied. An estate duty, however, may also provide for discrimination in regard to relationship, and if this were so, would be subject in this respect to some degree of evasion. The mere fact that the

¹ See paragraph 9 on the taxation of the joint Hindu family.

higher the value of the estate the higher the rate of duty leads to much higher returns of duty in the upper reaches of estate valuations than would be possible under the inheritance taxes where the estate is broken up before reaching the beneficiary. In the latter the rate of duty is fixed according to relationship and the amount of legacy, the tax therefore depending on the relationship and the size of the income. In favour of succession or inheritance taxes it may also be argued that there is a greater degree of abstract justice. This, however, may be subject to question. It is advantageous to have both forms of taxation. Thus in Great Britain there are both the Estate Duty and the Legacy and Succession duties. In the States of New York and Massachusetts both types are found, while in most other states a share or succession tax is in existence. The Federal Government confines itself to the estate duty and a gift tax. The theory underlying the estate duty is the idea of bequest and social privilege, while the idea of windfall or accidental income accruing to the individual, who therefore must be expected to pay, underlies the succession or share duties. In Adam Smith's words, this taxation is "perfectly clear and certain", and the time of payment "sufficiently convenient". It is also productive and cheap to collect. The tax is usually graduated in three ways. The amount may vary with the value of the estate to be transferred. This is so in the case of estate duty, which in Great Britain varies from 1 to as much as 50 per cent. The Federal tax in the United States is imposed on this basis. The tax may also vary according to the relationship of the beneficiaries to the deceased, the highest rate of tax falling on distant heirs. Legacy and succession duties in Great Britain and elsewhere vary according to consanguinity. Thirdly, the tax may also, as in France, Germany, Italy, Spain, and most other countries, vary with the amount inherited by each individual heir. This discriminates against leaving large sums to one or two persons only, and tends to prevent the accumulation of property among a few people. It is therefore eminently reasonable, and it is probably on this account that this third form of taxing is popular with the Commonwealth Governments of the United States. Lord Randolph Churchill, had he not impetuously sent in his resignation in 1886 as Chancellor of the Exchequer when he regarded himself as indispensable, would have imposed a graduated duty according to the total benefit received by each

individual and not according to the value of the whole estate before distribution.¹

II. THE EQUITY OF DEATH DUTIES

3. The State protects the property of the individual, and it is not unfair that it should come in at the death of the owner of the property and take a share in the form of taxation before it is passed on to the beneficiaries. As Gladstone well put it : "The carrying property in perfect security over the great barrier which death places between man and man is perhaps the very highest achievement, the most signal proof of the power of civilised institutions . . . and an instance so capital of the great benefit conferred by law and civil institutions upon mankind, and of the immense enlargement that comes to natural liberty through the medium of the law, that I conceive nothing more rational than that, if taxes are to be raised at all, the State shall be at liberty to step in and take from him who is thenceforward to enjoy the whole in security that portion which may be *bona fide* necessary for the public purpose".² The curtailment of the right of bequest in this respect on the part of the State is just. Bequest is a creation of the law modifiable by the State at will. Moreover, it is the existence of the State that makes the accumulation of private fortunes possible, and it is right that society as a whole should share and share progressively in this, the larger the estate the larger the share.

Apart altogether from social obligation there is the justification on the score of ability, whether regarded from the point of view of the owner of the property or his successors who enjoy an addition to their wealth by the accident of inheritance. Inheritance taxation may, therefore, be justified as a tax on accidental income as well as a payment for the privilege of inheritance which the State confers on its citizens. It is justified on these grounds. Other writers justify inheritance taxation on the ground that the deceased has no further use for his property

¹ Churchill also proposed to treat real and personal property alike, and to abandon the various rates according to consanguinity. See *Lord Randolph Churchill*, by Winston S. Churchill, vol. ii. chap. xv.

² Hansard, vol. cxxvii. p. 267, "Speech on Succession Duties", 12th May 1853. Cf. Sir William Harcourt Budget Speech, 1894, Parl. Deb. vol. xxiii. p. 489.

and the heirs enjoy an unearned windfall. On this ground there is really no sacrifice and therefore such taxation is just. Others regard inheritance taxation merely as on increments of income and, therefore, subject to ability and sacrifice doctrines which apply to income tax. Others again regard the State as a silent partner in the accumulation of fortunes and, therefore, entitled to a partnership share. While others again regard it as a means of reducing large fortunes and thereby reducing inequality in wealth distribution. Death duties are a useful complement to the taxation of income although charged on a different basis as a test of ability, viz. capital, and when taken with income tax they afford a better index of ability than the income tax by itself. The estate duty extends to assets untouched by the income tax, as, for example, pictures, furniture, jewellery and other goods not producing a money income, and also to increases in wealth from the unearned increment in land and capital transactions. It adjusts the unfairness of an income tax where the nature of income cannot be adjusted to any great degree as where A, B, and C each have the same income, say £10,000, from earnings, speculative shares, and gilt-edged securities respectively. Both B and C are better off than A, and C than either A or B, but all pay the same amount of income tax in Great Britain except that A gets the earned income relief. The lower taxation, for example, on the value of B's capital at death tends to adjust the inequality between B and C and indirectly between A and C. Tax exempt securities or bonds, especially common in the United States, escape taxation under income tax, but do not do so under inheritance taxation. Thus, with this form of taxation, equality is secured to a greater degree than otherwise would have been possible. The estate tax in most countries is light in the lower ranges of capital value but in the higher ranges is so heavy in some countries as to lead to evasion by gifts *inter vivos* or by the formation of companies by landowners to escape death duties.¹ The following table shows the burden clearly in the case of Great Britain. It gives the net annual payment required to meet the estate duty in the case of a married man, aged forty-

¹ In Great Britain gifts *inter vivos* are subject to death duties if made within three years of death. The avoidance through the formation of a company leaving the testator in control of the property has now been provided for by legislation. A land company can be taxed in certain circumstances on the death of the transgressor of the property.

five, with three children, deriving the whole of his income from investments. The figures in brackets are the results if half the income is earned and half investment income. It is assumed that an individual assures for such an amount that after payment of death duties his original capital remains intact. It is also assumed that the value of the estate remains the same and the rates of estate duty do not alter.

Total Income.	Equivalent Capital.	Year 1930-31.			Total.
		Income Tax.	Surtax.	Net Insurance Payment to provide for Estate Duty.	
£ 5,000	£ 100,000 (50,000)	£ 1,007 (951)	£ 306 (306)	£ 819 (274)	£ 2,132 (1,531)
10,000	200,000 (100,000)	2,132 (2,076)	1,381 (1,381)	2,322 (812)	5,835 (4,269)
25,000	500,000 (250,000)	5,507 (5,451)	5,681 (5,881)	8,583 (3,012)	19,771 (14,344)
50,000	1,000,000 (500,000)	11,132 (11,076)	14,506 (14,506)	25,349 (8,167)	50,987 (33,749)

The cost of income tax, surtax, and insurance against death duties in the case of an income of £50,000 from investments actually exceeds the income by nearly £1000 a year. Before the War the cost would have been £9268. If half the income were earned and half investment the amount payable on £50,000 would have been £33,749 as against £6092 pre-War. It seems advisable, as suggested by the Committee on National Debt and Taxation, to have more even progression in the estate duty than that which now obtains, and this should be done rather by lowering the scale on the highest ranges than by raising it in the case of estates below this. It is right that with an increase in wealth as with an increase in income there should be progression, as there is diminishing utility of wealth with the increase of wealth just as there is diminishing utility in the increase of income. The estate duty takes as a rule no account of the ability of the successor or successors, and in this respect is open to criticism from the viewpoint of equity, although it may be argued that the estate tax is related to the testator and not to the inheritor. Similarly it takes no account of the number of the beneficiaries. An estate passing to several sons pays, in Great Britain, the same

as an estate passing to one son, as does, too, an estate passing to a poor man and to a very rich man. The rates of duty are sometimes held to be confiscatory, except in special cases of landed property or of quick successions or under the Rignano scheme analysed below. A large agricultural property is not likely to retain its character as a single estate for many generations, unless the successive owners have a considerable amount of personal property as well. On the other hand, in the case of a property not consisting wholly or mainly of land it would take many generations to "destroy" a property, even if, contrary to the usual association of age with wealth, the capital value of the property between the series of deaths be taken as remaining constant: for, as the estate is diminished, the rate of duty applicable to it also diminishes. The history of an estate depends, in reality, on a great many factors, including, *e.g.*, the number, character, and ability of a testator's children. If the general factors make for dissipation of the estate, the estate duty will, of course, assist in the process. But its part, under the present scheme of graduation, can only be very limited.¹ In a large agricultural estate the expenditure required is very large in comparison with the money yield, and high taxation results in the breaking up of estates and lessened employment in rural areas. The cause, however, has not been excessive taxation alone, or even mainly excessive taxation, but the high level of the owner's expenditure. In recent years, in regard to agricultural land, agricultural owners have not been able to save out of income to pay death duties as have others in other walks of life with equal wealth. Large agricultural estates are in England and several other European countries no longer an economic proposition, and in consequence have to be broken up. The Board of Inland Revenue in Great Britain analysed the statistics of estates over £15,000 for the first half of 1921 and found that about 2 per cent contained 50 per cent of agricultural land, about 4 per cent from 20 to 50 per cent, and concluded that the number of cases where payment was specially difficult was comparatively small. In the British system of death duties agricultural property was

¹ If the present rates of British estate duty are applied to an estate of £25,000 it will take fourteen generations before it falls below £10,000 and thirty generations before it reaches £5000, assuming that the estate passes to a single heir and no provision for estate duty is made out of income. See also page 530.

exempted from the increases in estate duty generally, and eight years are allowed for payment of duty. A writer in *The Times*¹ cited his own case of an inheritance of 30,000 acres of agricultural land for which death duties amounted to £200,000. Owing to taxes and rates this estate yielded no income to the proprietor. He was faced either with borrowing on mortgage or with selling a portion of his estate for what it would fetch. In the former case, he said that he would have to pay interest with moneys which would otherwise have been used to keep the land in good condition; in the second, he would require his tenants to buy the land, and their resources were as meagre as his own. In either case the capital required to maintain the land, buildings, and stock in proper condition was withdrawn, and, in his opinion, this deliberate shifting of the burden of taxation on to the shoulders of the few was harmful in itself; it was also so because the proceeds were squandered on pensions and the dole. "I do not", he said, "write this letter in any way in opposition to death duties as such. On the contrary, I consider death duties to be a very fair kind of tax, so far as the individual inheritor is concerned. Nor do I write this letter in the interest of landlordism. I write it because what is wrong is not death duties but the way in which the proceeds of the death duties are used to-day. It is simply suicidal to go on taking capital² out of the countryside and spending it for current revenue purposes, mostly in the towns." Special hardship is sometimes caused to agricultural landowners, and in a few cases the damage may be large. At the same time it would take, at the present rates of estate duty in Great Britain and on the assumption that the estate were to pass once in thirty years, 150 years to reduce an estate from £2,500,000 to below £300,000. It has been estimated that out of 6000 estates exceeding £10,000 which pass annually about 3 per cent only pass again within the next five years, and in the case of land or a business other than a company some relief is given when the property passes a second time in five years. Five per cent may pass within the next five years and 7 or 8 per cent in the following five, or only 15 or 16 per cent may pass a second time within 15 years. Quick successions are often due to the first of the two persons having

¹ London issue of 1st May 1930.

² See § III. below on the Taxation of Capital Fallacy.

enjoyed the estate for an unusually long period, and thus the estate was free from duty for a long term of years. Against the repetition of the burden within five years or a similarly short period must be set the likelihood of a long or fairly long spell of immunity. Death duties are said to have a disadvantageous effect on the private business man, especially in times of high taxation. Duties are not, of course, levied on the public limited liability company but only on the estate of the testator. It is, therefore, the private firm or company financed by a single person or one or two persons that is affected. A correspondent of *The Times*, the owner of a private limited company owned practically by himself and his family, pointed out that his business had increased year by year and there was almost no unemployment, indeed the reverse. "Whereas before the Budget (of 1930-31) I had to look forward to an estate duty of £196,000, under the new conditions on the same estate that tax will now be £56,000 more, or £252,000. If our business continues its present progress for the next five years and makes an additional average annual profit of £30,000, my estate would, at the end of that time and on the same basis of valuation, be involved in additional estate duty of £148,000, even though the total increased profit, after income tax, had only left me £116,500. This means that, by forging ahead, adding new plant and giving large additional employment, my estate would in the event of my death at the end of five years be the poorer by £31,500, apart from the sums I should have to pay in surtax. It will take a very heroic spirit to continue pioneering under these conditions. Instead of my allowing things to go ahead as they have done, I must now 'reverse' and withdraw from the business much more than the estate duty, as surtax has also to be paid on the amounts withdrawn to meet the tax collector. Is there not here a key that may explain much of our unemployment? Is it not really a blind and vicious circle to drag vast sums of money from their natural places of use and employment, making people idle, and then needing more and more to give them because they are idle? This will always happen so long as capital is taken from industry to the extent prevailing in the modern method of taxation. We can only get salvation from a drastic cut in our national expenditure."¹ It is difficult to generalise from the

¹ London issue of 3rd May 1930.

particular regarding the effect of death duties on private businesses. In industrial countries, however, the great concerns are mainly public companies which are not directly affected by death duties, and private businesses, as investigation shows, are not much affected by such duties. It would be difficult indeed to find a method of raising money less disturbing to industry than death duties. It depends to a great extent on the number of estates falling in where there are not enough free assets outside the business to provide for payment of death duties, and a statistical inquiry similar to that conducted by the Board of Inland Revenue in the case of Great Britain would have to be undertaken.¹ The inquiry was to ascertain the validity of a criticism that death duties fall with particular severity upon the estates of those in private business, and that in large estates of this class the duties were paid by raising bank loans which crippled the future development of the business. The Board made a very detailed analysis of all estates exceeding £10,000 net capital value and including trade assets which came before it between January 1 and March 31, 1922. The results are set out in 23 statistical tables which show that during the period taken 1342 estates of a value exceeding £10,000 came under notice, and in 373 cases, or 27.8 per cent, the estates had trade assets. The net capital value of all estates in the sample was £54 millions, and that of the estates which included trade assets amounted to £22 millions or 41 per cent of the total. In 308 cases out of 373 the net trade assets were less than half the net estate. In the remaining 65 only 3 had their net non-trade assets less than the duty on the whole estate, or 0.8 per cent. If all estate debts were regarded as a charge on the non-trade assets in only 12 cases, or only 3.2 per cent, was the net amount of those assets insufficient to meet the duty on the whole estate? In only 24 out of the 373 cases in the sample were the cash and liquid assets (excluding realty and leasehold property) insufficient to meet the estate duty payable. In short, in an exceedingly small number of cases did the estate duty entrench upon the trade assets, and the Board concluded that "The most laborious statistical examination of a problem of this description cannot pretend to give a full picture of the real measure of hardship

¹ Appendix xx. to the Report of the Committee on National Debt and Taxation, 1927—"Estate Duty v. Private Businesses".

in cases where hardship occurs. Nor in the infinite variety of human circumstances can such an investigation take account of the close interrelations which must often exist between the employment of the various assets comprising one man's resources. It has been necessary in this investigation to draw distinctions between trade and private assets, and in individual cases this hard and fast line may obscure and distort the true facts when viewed as a whole. Such defects are unavoidable. But making every consideration for abnormalities of this kind, it is suggested that, viewed broadly, the burden of the estate duty does not appear to be a major factor tending towards the disintegration of private businesses, whether carried on by sole or partnership traders, or through the medium of a private joint stock company."

The estate duty or tax is inequitable as between comparable estates when deaths occur more frequently in one than in another. Adam Smith was the first to indicate this. "Such taxes, even when they are proportioned to the value of the property transferred, are still unequal; the frequency of transference not being always equal in property of equal value."¹ The British system of death duties recognises this when it allows some relief in the case of land or a business other than a company where the estate passes a second time within five years. This will tend to inequality among individuals. The estate duty is levied at a fixed and arbitrary point of time. Much, therefore, may depend on the date of the testator's death. Thus when the estate is liable for duty the prices of securities may have fallen considerably, and the value of the estate may in consequence be affected. In 1933-34 the gross capital value of estates paying duty in Great Britain was £562 millions as against £409 millions in 1920-21, and a considerable portion of this was due to the increased value in securities. Again, changes in the rates of duty tend to add further inequalities as fortunes accumulated in the same period will pay different rates according to the death of the testator. Thus British estate duty rates levied on the various grades of estate very nearly doubled, and in some cases did double, between 1919 and 1925. Again, over a period two estates of the same value may have been built up in a very different manner. The income from one may have grown rapidly in the years before the testator's death and so the capital value of the

¹ *Wealth of Nations*, Bk. V. ch. ii. Appendix. (Cannan edit., vol. ii. p. 347.)

estate, while in the other the reverse is the case. The estate duty does not make allowance as an income tax for the difference of ability over this period. The estate which accumulated only gradually would not pay the same income tax as the other which grew rapidly in value. Yet on the death of both owners leaving the same fortune the estate would be the same and the difference of ability to pay in the interval would be neglected. No account is taken in succession duties in some countries, France being a notable exception, of the wealth of the beneficiary at the time the legacy is received. In the British system these succession duties are but a minor part of the taxation of inheritance. They differentiate to some extent the total burden of death duties by the principle of consanguinity which, however, may be capable of future development. The succession taxes in Great Britain, though graduated with reference to relationship, are not graduated with reference to the amount received, and in this respect are, from the point of view of ability to pay or of progression, among inheritors less satisfactory than those where at least some amount of graduation has been introduced. A single inheritance tax, graduated at a rate by reference to the amount received or in addition or as an alternative with reference to the total wealth of each beneficiary, has sometimes been suggested, whether the inheritance is under a will, intestacy, or settlement. It is, however, desirable on principle to have both categories of death duties in operation as far as possible, an estate tax and also a share or succession tax. The double system has come to stay. A single inheritance tax in Great Britain, for example, according to the Revenue authorities, would lack the productiveness, the cheapness of collection, and the balance of the double system. Drastic provisions would have to be made against evasion. It appears to be practicable if the tax were graduated according to the benefit received. If the tax were graduated by reference to the total wealth of the beneficiary this would be more difficult to work as it would involve considerable administrative difficulties. The greater the number of graduations of the rate, the more accurately would the wealth of the beneficiary have to be calculated, and there appears to be ground for believing that there would be delay in payment of the tax unless the executors paid the tax at the full rate of duty and subsequently claimed a rebate when the total wealth was declared.

III. THE TAXATION OF CAPITAL FALLACY.

4. One of the commonest fallacies in the whole field of public finance, a fallacy so general that, in Bacon's phrase, it has become an idol of the market place, is that a tax on capital is bad in principle. It is sometimes stated as a maxim to be followed, indeed a very ambiguous maxim, "tax income if you like but never capital : a tax on capital beggars you and checks the accumulation of capital to a far greater extent than does income tax". Another form of the fallacy is that when taxes are paid out of capital a country is living on its capital instead of on its income. This mistaken belief can be traced to the classical Economists of the earlier part of last century. While pointing out that "All taxes upon the transference of property of every kind, so far as they diminish the capital value of that property, tend to diminish the funds destined for the maintenance of productive labour" and "are all more or less unthrifty taxes that increase the revenue of the sovereign which seldom maintains any but unproductive labourers, at the expense of the capital of the people, which maintains none but productive", and also that these taxes violate his canon of equality when "the frequency of transference not being always equal in property of equal value", Adam Smith did not go so far as Ricardo in condemning such taxation. Adam Smith much overstates, indeed, the case that inheritance taxation diminishes the funds destined for the maintenance of labour. The heir, however, in Adam Smith's view, was generally well able to pay the tax at the time when it was levied. The taxes "are in no respect arbitrary, but are or may be in all cases perfectly clear and certain. . . . They are levied at very little expense, and in general subject the contributors to no other inconvenience besides always the unavoidable one of paying the tax." He suggested to Lord North the progression of the probate duty with the size of the estate. This came into effect in 1779, three years after the publication of *The Wealth of Nations*.¹ Ricardo,² individualistic in outlook,

¹ Bk. V. ch. ii. pt. ii. appendix to articles 1 and 2. (Cannan edit., vol. ii. p. 347.)

² Cf. Ricardo's *Principles of Political Economy and Taxation*, ch. viii. : "For the general prosperity, there cannot be too much facility given to the conveyance and exchange of all kinds of property, as it is by such means that capital of every species is likely to find its way into the hands of those who will

condemned the taxation of capital without considering carefully the sources from which the tax was paid and the effect on the body of taxpayers and the State as a whole. Even Marshall failed to free himself from nineteenth-century orthodoxy when he wrote that "The old objection to taxes on inheritances that they are paid out of capital seems to me to have great force still".¹ Henry Sidgwick, however, whose "natural bent", in the words of Bryce, "was to distrust all that was obvious and to discover flaws in every accepted doctrine", pointed out that the drawback to death duties "is not likely to be at all equal in proportion to the similar effect that would be produced by extra taxes on income; in fact, the limits of taxation on inheritances will be practically determined for the financier rather by the danger of evasion through *donationes inter vivos*, than by the danger of checking industry and thrift".² The twentieth century, which has witnessed specially since the War an extraordinary development of this form of taxation, has separated clearly two things responsible for the fallacy, the basis or object of assessment and the source of payment or the resources from which the tax is paid. A tax like the estate duty or the American property tax (both are taxes on property—one an occasional tax occurring on an average once in thirty years, the other an annual tax) is a tax assessed on capital and sometimes on capital that does not yield any income. It may be paid from the payer's own income. Conversely, a tax on income may be paid from capital obtained by the sale of securities or by borrowing temporarily from a bank. Merely to say that a tax is assessed on capital or on income is not enough. We have to inquire whether it is eventually paid from resources which would have become, but

best employ it in increasing the productions of the country. 'Why', asks M. Say, 'does an individual wish to sell his land'? It is because he has another employment in view in which his funds will be more productive. Why does another wish to purchase this same land? It is to employ a capital which brings him in too little, which was unemployed, or the use of which he thinks susceptible of improvement." Compare Mill, *Principles*, Bk. V. ch. ii. § 7. "The amount which would be derived, even from a very high legacy duty, in each year, is but a small fraction of the annual increase of capital in such a country (*i.e.* which increases rapidly in wealth); and its abstraction would but make room for saving to an equivalent amount: while the effect of not taking it is to prevent that amount of saving, or cause the savings, when made, to be sent abroad for investment."

¹ C. 9528 of 1899, p. 123; cf. *Official Papers* by Alfred Marshall, Macmillan, 1926, p. 357.

² *Principles*, Bk. III. ch. viii. § 11.

for the payment of the tax, new capital, *i.e.* from savings, or from resources which would have been used for consumption, *i.e.* by the taxpayer reducing his consumption. When estate duty is paid it is often paid out of the capital of the estate by the trustees realising securities or selling real property. The State rarely receives actual capital.¹ It almost always receives resources obtained by the selling of securities or other form of property, resources which, but for the tax, would have become new capital. The purchaser or purchasers—there may be a chain of purchasers—of the property sold buy with cash obtained from their savings or by the sale of some other securities. If the owner is forced owing to the high inheritance taxation to liquidate part of his property the loss is an individual loss, but from the social aspect the property is unimpaired. The loss to the seller is balanced by the gain to the seller who buys these securities out of savings from income. In other words, when a man dies his executors may have to sell securities to pay death duties, and unquestionably there is then a diminution of this particular estate. The persons buying the estate or the securities may have realised other securities to make the purchase. There will be merely a redistribution of capital. The capital of the country suffers no diminution ; whether the State loses revenue or not depends on the final redistribution among the different classes of income tax and surtax payers. These facts are sometimes overlooked by those who argue that there is evaporation of capital consequent on the levy of death duties. There will be no loss of existing capital, but new capital may be prevented from coming into being. There may be a long or short series of transactions, but finally the payment of death duties will be from savings out of income. At the time of payment of the tax there is no destruction of capital ; there is a change of ownership of capital, a transfer from one owner or the trustees of that owner to another, and potential new capital to the full extent of the duty is, as we have said, prevented from coming into existence. Death duties do not destroy existing capital any more than does income tax and surtax, which in so far as the tax is paid out of savings and not by reduced consumption also prevents new capital from

¹ The British Treasury accepts land in payment of death duties only if it can be utilised for some public purpose. That is, of course, very rarely the case.

coming into existence. Of the two taxes, indeed, it is sometimes argued, death duties have some degree of ethical superiority, for they tax a man at a time when he is no longer able to feel it, and, therefore, death duties cannot be said to act as a deterrent to enterprise. Indeed, there are grounds, as noted below, for looking on these as a stimulus to enterprise. The beneficiaries, while naturally desiring to have the full proceeds of the estate, cannot argue that their industry is taxed. Both a tax on capital and a tax on income are assessed on wealth, and one may be, and usually is, not less harmful in its effects than the other.¹ Both diminish income and unless imposed with care may even destroy wealth. We have to see whether the proceeds of the tax are put to good or bad uses, a test applicable to all other taxes. The point is not whether a tax is imposed on capital or on income, but whether the proceeds are used well or ill. Both death duties and income tax are provided from the national income and prevent potential new capital from coming into existence. We must not think because in a particular estate it may be paid from capital that there is a loss of existing capital, as ultimately it must be met from savings from income. Ordinarily the effect is, as in the case of income tax, a transfer of capital within the nation. High rates on inheritance may be offset by reductions in other taxes. These reductions may affect that portion of wealth which is saved or converted into capital quite as likely as they may be directed to the purchase of consumers' goods. The reductions in other taxes may increase the volume of saving of the non-inheritance taxpayer and so compensate the loss brought about by the payment of the death duties. If the payment of the inheritance tax affects that part of wealth which ordinarily will be devoted to the purchase of consumers' goods, a payment of the tax may mean a net deduction in the volume of capital available for private investments. Here

¹ It is sometimes argued that income taxes are a greater check to the accumulation of capital than death duties (*vide* Dalton, *Public Finance*, p. 113, and Gerbino's article in the *Economic Journal*, June 1925, on p. 243: "The more rapid extinction of the British National Debt"), where, according to Gerbino, "it seems probable that saving is more reduced by the prospect of having to pay the income tax year by year than by the more remote prospect of the succession duty having to be paid at an uncertain date. To confirm this conclusion it is also to be observed that while the taxation of inheritances hardly disturbs the development of the economic activity of productive concerns, the taxation of income, by diminishing reserves, hinders their ulterior development."

again in the last resort the matter rests on the relative merits of public expenditure and private investment. We can never assume what lies also at the basis of the capital destruction fallacy that what the Government receives in taxes, including death duties, is a total economic loss to the country. The State in spending the proceeds of death duties is not wasting year by year its capital but is merely transferring capital from one of its citizens to another without in reality becoming poorer by doing so. Governments, it is true, spend the greater part of their tax revenue on consumption goods, but they nevertheless, especially in the present century, are building up capital rapidly. There are such productive works as irrigation and railways which add to the wealth of a country, as in the case of the large irrigation works of India and Egypt and the network of railways throughout India which are productive financially to the State as well as to the railways themselves. Governments are spending revenue in making roads, in scientific investigations, etc. If the testator or the inheritor is a national of say, the United States, and the property is in Great Britain, his income in the United States may pay the duty or share tax, and it may not be paid from the national income of the country in which the estate is. This case is exceptional. When death duties are heavy the payment of the tax in certain circumstances is distributed over a number of years in nearly all countries—in England as many as eight—and when the custom of insuring the payment of death duty is becoming increasingly popular, with the result that on the death of the insurer the capital value of the estate remains and hasty liquidation is avoided. We see that in both these cases the duties are in the nature of an annual tax paid by the owner, an additional tax paid out of income. It has sometimes been suggested that the sum insured for the purpose of paying death duties should not be added to the total value of the estate when death takes place. The exemption from death duties of that portion of an estate which is due to insurance might encourage saving in the case of the lower or moderate-sized estates.¹ Insurance against death duties may

¹ In the higher ranges of income there is a point when income tax, surtax, and insurance against death duties may actually exceed the income derived from the estate. In the case of a married man, aged forty-five, with three children, deriving all his income from investments bearing 5 per cent, the point is reached at an estate of £1,000,000 bringing in an income of £50,000 a year.

also bring the estate into a higher grade of taxation. On the other hand, if the estate holder dies after having paid only one premium or only a few premiums it is clear that the greater part of the funds to meet the duty has been met by the insurance company and not by the estate. Life insurance is after all only one among many forms of saving, and as other forms of saving are taxed by death duties it could be unfair to exempt only insurance. Already insurance is adequately recognised by privileges in regard to income tax. Moreover, the Government, it has been calculated, would lose heavily by such a proposal. In Great Britain it has been put at as high a figure as £20,000,000 a year.¹ On the whole it seems that insurance must be included in the estate for the purpose of duty, subject to certain privileges which they already enjoyed. There is, we may add, a tendency to separate rigidly capital from income to such a degree as to forget the late President Hadley's remark that "capital and income are not separate things but different ways of measuring the same thing".

One of the results of the fallacy of assuming that death duties are paid from capital and are not paid from national income as are other taxes is the suggestion that death duties should be earmarked for capital expenditure in the budget, especially for debt redemption. It is said that if death duties are spent as ordinary revenue the country is living on its capital. Not a few continental writers in addition to British economists, from Ricardo even up to our own day, have suggested that the revenue from death duties (or inheritance taxes) should not be used for current expenditure but for capital expenditure. American writers like Richard T. Ely² have sometimes advocated the same view. Some German writers have held that death duties should be spent to provide a capital fund for schools, hospitals, etc., and Rignano³ would have the proceeds in the form of securities and other claims to capital wealth used to further the cause of State socialism. Influenced by these writers the legislators in certain states of Germany, the United States, and Canada have made provision that the proceeds of these taxes should be devoted to schools, hospitals, asylums, prisons, and even in the

¹ This was arrived at on the assumption that all taxpayers at present liable to death duties took out insurance and that the State would be deprived of the death duties payable on such insurances.

² *Evolution of Industry Society*, p. 300.

³ See below, p. 546.

Swiss inheritance tax social insurance is linked up with it. The earmarking of this tax for a specific purpose, perhaps, may win the support of those who cling to the fallacy and may have some psychological value, especially in times of high taxation, when the owners of estates think that an extravagant and rapacious government is squandering the proceeds of their fortunes on large civil service establishments. On the other hand, such a procedure would mean the crediting to debt redemption the proceeds of these taxes regardless of the general budget position. In theory there is no more justification for using the death duties for the redemption of debt than there is for using the income tax for that purpose. The use, however, of death duties for this purpose might have a considerable psychological value, but in the case of Great Britain it would mean raising another £80,000,000 by direct or indirect taxation and thus adding yet another burden to those burdens falling upon individuals and not least upon industry. It would also perpetuate the erroneous idea that a tax on capital is paid out of capital when assessed on capital, although no one would argue that a tax assessed on racehorses need necessarily be paid from racehorses (*i.e.* by selling racehorses) or from resources that would otherwise have been spent on racehorses.

IV. THE EFFECTS OF DEATH DUTIES ON SAVING AND ENTERPRISE

5. The effects of death duties on saving and enterprise have been in recent years, especially since the War, the subject of detailed investigation by official committees, non-official bodies such as tax associations, and by writers on Public Finance in many countries. The results of these inquiries show that while death duties take away actual capital from individuals, the expenditure by the State may add to the power of accumulation by its inhabitants even more than the amount of capital taken from individuals and, all things considered, as compared with other taxes, death duties are only to a small extent more damaging to saving. When an estate duty has to be paid it is often necessary to pay by selling securities, the equivalent of several years' income, and this is, as we have seen, achieved from resources which would otherwise have been saved and become

new capital. In some countries, such as Great Britain, most of the estate duty is derived from the largest estates. The tax may be met by economies in consumption, but this is seldom the case in the largest fortunes. If the Government spends the proceeds (as they do in the case of income tax revenue) in paying interest on public debt the tax-paying classes benefit considerably from this transfer of capital. If, on the other hand, the expenditure by Government is uneconomical or non-productive or wasted, the realised savings of the nation may also be wasted just as if the money had been raised by other taxes, such as a tax on investment incomes. No special disadvantage in this respect rests with death duties. Death duties, an occasional property tax, should be compared with the annual tax on investment incomes. The income tax tends to stimulate both saving and enterprise on the part of the taxpayer as he has economies forced on him. His consumption may be curtailed, but income taxes are not paid by those on the minimum of subsistence, and these taxes are paid out of otherwise saved income, the taxes being paid in lump sums. Potential new capital to the extent of the income tax is precluded from coming into existence. In the case of death duties, on the other hand, the owner of the estate, unless he insured against death duties, finds that the deferred tax does not interfere with the maintenance and increase of his standard of comfort. He takes a rosy view of the expectation of life and procrastinates in saving. He ignores for the time being, the estate tax, is selfish at the cost of future generations, and is like most of his fellows, anxious to die rich. It is sometimes said that the initiative of the rich man is damped by estate duties, and he is pictured hard at work piling up a fortune for his heirs, endowed with a great love of his family and thinking of nothing but what he will leave behind. A study of our rich men shows that family does not count at all or very little in the great fortunes that have been piled up. They enjoy being able to make money and death duties have no effect on their motives for accumulation. Some, and it seems with more truth, argue that the existence of a death duty will be an incentive to a man, and this is the basis for Rignano's scheme. The truth is that in the annual tax on investment income all of these motives are not in operation. The income tax payer has to think of his annual income and surtax payments

and must save accordingly. A considerable part of the income tax is paid by very many below the sur or super tax level, and on balance the income tax payer, as compared with the future payer of estate duty, is forced to save and forced to work. In the higher incomes this stimulus diminishes. The estate duty has not so much influence on saving and work as in the case of income and surtax, although in the case of those who insure against death duties¹ and those who expect to leave small estates increased saving may take place. On account of the many and very varied countervailing considerations it is difficult to generalise on the ultimate effect of death duties. Exceptional cases often strike the imagination, especially in the public press, as the recent instance of a man who by dint of hard work amassed a fortune in securities of £200,000 which brought him in, after paying taxation, about £6500 a year. He retired from business and had an expectation of life of about thirty years. His expenditure was about £5000 a year. Being a bachelor he had made up his mind to sell his securities and to put the proceeds in the Bank of England and other banks on current account bearing no interest and to live on his capital. As death duties would swallow up a third of his estate he believed that it would make little difference to his successors if he left only £100,000 instead of £200,000. He would avoid income tax and surtax and not have to seek refuge to avoid tax by going to Jersey, Ireland, or Monte Carlo. He also believed that death duties and surtax would be almost certainly increased in the not distant future. If all circumstances are examined and weighed up carefully it may be possible to summarise the effect of death duties on saving and enterprise as follows : (1) Estate duty does not make for *saving* as much as does the income tax or equivalent lump sum taxes assessed annually, mainly because it is a deferred tax and drawn from the largest fortunes. The difference, taking all factors physical and psychological into consideration, is not very great. (2) Estate duty is less damaging to *enterprise* than the income tax, although in certain cases, a minority of cases, it may inflict serious hardship on individual owners of landed

¹ The effect here is similar to that of the payment of income tax. Saving is retarded in so far as premia are paid from money which would otherwise have been saved. Saving, however, is retarded to a less extent than in the case of an income tax yielding the same amount of revenue.

estates¹ and private businesses : (3) A substituted annual tax on income confined to incomes corresponding to the capital on which estate duty is paid and bringing in a revenue similar to that on inheritance taxation at present in force would be more prejudicial to *saving* and *enterprise* than the system of death duties, especially in view of the high level of taxation on incomes which at present obtains. The British Committee on National Debt and Taxation was of opinion that "Under the yearly tax, those who lived wholly or mainly on investment income might, on balance, be stimulated (and in some cases even physically compelled) to effect some extra economies. On the other hand, the differentiation against income from savings as compared with earned income would be more obvious in a yearly tax than in a tax deferred till death. It seems probable, therefore, that to some extent it would tell against saving out of earned income. In the larger estates the burden would be a serious addition to the income tax and super tax, and would be more depressing than the prospect of estate duty at the uncertain date of death."² (4) A tax on property at stated intervals in place of at death would have a similar effect on *saving* and *enterprise*, in the long run, as a substituted tax on income. (5) It has sometimes been said that, especially in times of depression, there is excessive saving, that the virtue of one generation becomes the vice of another, and that a nation's savings may be out of all proportion to what they were or ought to be. Excessive saving can indeed be a not unimportant cause of a trade depression. Thrift in Great Britain since the War has been growing among all sections, especially through National Savings Certificates, Post Office Savings, insurance, building societies and pension schemes. Can it not be said in these circumstances that the Government is justified in using death duties for revenue purposes ? There is ostensibly no urgent need for new capital when hundreds of million pounds are lying about unproductively and every new

¹ The high rates in Great Britain, France, and certain other countries in Europe have broken up the old aristocratic family estates, and with this, as Einaudi points out in *Il problema della finanza postbellica* (1919), there has come about the dissolution of old families which in turn has broken tradition and the fine old federation of families in the State. This has become very noticeable since the War. The exemption from inheritance taxation within the family in Italy in 1923 was intended to strengthen the family, which was held to be the foundation of national unity.

² Cm. 2800, para, 534, p. 194.

issue is heavily over-subscribed. The issue to be decided is, in short, that while death duties do prevent potential new capital from coming into being, is this new capital desirable or not? The answer to this question must be answered in the circumstances of any given year.

Wealth in the twentieth century is being produced at a rapid rate. Immense accumulations of resources, called capital, consisting of buildings, machinery, and other things of a material nature used in production are taking place. The amount of capital taken in the form of inheritance taxation which might otherwise go to maintain the productivity of labour is not in normal times of importance when compared with the total capital in use, the annual increase of capital, or total savings. The Committee of the British Association appointed to investigate the economic effects of inheritance in Great Britain reported that although the cases chosen by the method of sampling were not sufficiently large to form the basis of firm generalisations, yet it was possible to conclude from the samples (1) that there was a definite progression in the proportion of inheritance to total fortune, but the larger fortunes had been made to the greatest extent within the lifetime of the individuals and owed least to bequest; (2) that for fortunes in general the sums given away during life were more than twice the sums received during life; in the larger estates the sums given away were five times the sums received, and the practice of giving away during lifetime was much more marked in the larger estates where 28 per cent was alienated against 5 per cent in the smaller; (3) that it would be dangerous to infer that there was any general tendency for the proportion of inheritance in large fortunes to diminish in more recent years.¹

V. GRADUATION ACCORDING TO TIME AND THE RIGNANO PLAN

6. We have seen that in the British system of inheritance duties some relief is given in the case of land or a business other than a company if a second succession occurs within five years of the first. Similarly in the United States a deduction is permitted in the Federal tax if the property passes a second time

¹ Report of the Inheritance Committee—Economic Science and Statistics Section British Association, 1930.

within five years. The principle of the time element is recognised, and it has been suggested that this should be developed by applying it to estate duties and succession taxes more frequently than has hitherto been the practice. It is proposed to discriminate between that part of the testator's estate which was accumulated during his lifetime by his own efforts and that part which he inherited or received as a gift. The older the estate the higher the taxation on the portion inherited. The principle that the tax should be graduated according to the age of the estate, *i.e.* according to the number of times it has already changed hands, is attractive and worthy of careful consideration. It has been discussed by experts in various countries, for example, by the Board of Inland Revenue and the Committee on National Debt and Taxation in Great Britain and by the National Tax Association in the United States. The proposal is not yet a century old, but in recent years has, owing to the desire for additional revenue from this source of taxation and the highly progressive rates that are to be found in some countries, been growing in popularity. Unfortunately the plan has been handicapped from the fact that it has been mixed up with State socialism and not always considered from its taxation standpoint. Thus Huet, writing in 1853,¹ advocated that after the second generation inherited wealth should go to the State on the ground that the right to leave property depended on the testator's ability to produce wealth, and on ethical grounds it was not fair that wealth not earned by the testator himself should be allowed to descend. After the second generation it must, therefore, go to the State. Rignano in his well-known plan² put it forward as "the sole way to achieve an effective and gradual nationalisation of private capital without injuring the delicate mechanism of economic production". The estate of every testator would be divided into two parts, and to that part inherited or received by gift a discriminatory tax would be applied. On the other part, *i.e.* the wealth accumulated by the testator through his own efforts in his lifetime the ordinary basic rates would be levied. The differential rates of

¹ *Le regne social du christianisme* (Paris, 1853).

² *Socialismo in accordo colla dottrina economica liberale*—chs. iii. and iv. Rignano (Turin, 1901): *Per una riforma socialista del diritto successorio*, Rignano (Bologna, 1920). See *The Social Significance of the Inheritance Tax*, Shultz—a translation of Rignano, New York, 1924, and *The Social Significance of Death Duties*, Stamp (adapted from Shultz's translation).

tax might be fixed so as to remove the inheritance in one or in two stages from the original saver. The full project of Rignano is best described in his own words: "Once the estate of the testator was thus quantitatively divided, the nation would not levy on the portion due to his labour and thrift any higher duties than it imposes to-day. On the portion which the deceased inherited directly from his father the nation would make a much heavier levy, say 50 per cent. On the portion which came to him from his grandfather through the medium of his father, there would be laid a very heavy tax, possibly 100 per cent."¹ The tax might also be levied without separating the inheritance of, for example, the father from the grandfather. Thus there would be a lower rate on that part of the estate due to the work and saving of the testator and a higher rate, in practice not altogether a confiscatory rate, on the inherited portion. The rates of tax and the length of time before the State would absorb inherited wealth could vary on account of the financial stress and other economic considerations in each country. The theory underlying the Rignano plan is that testators in the majority of cases concern themselves with their immediate heirs and not with their heirs' heirs. It may be argued with considerable force that a limited discrimination on the Rignano plan would not only yield more revenue to the State, but it would be less damaging to saving than an increase in death duties of the type at present in force, because it would induce people to save for their immediate heirs who would be taxed on this part of the estate at a lower and not at a confiscatory rate.² The tax would have similar advantages to a succession tax, which imposes higher rates on more distant heirs as in the case of the British succession duty, and it could be levied in addition to existing rates, if any, on the size of the estate, on the total wealth of the beneficiary, or on consanguinity.

¹ Cf. p. 38, *The Social Significance of Death Duties*, Stamp, quoted in Cmd. 2800.

² Rignano had really two main ideas in view. Firstly he desired to use his plan to transfer the title of wealth to the State. This was his State socialist point of view. His second aim was that the project would induce people to save for their heirs because "as regards one's own children, every sum saved by the heir of a given estate would come to have, in his eyes, a much greater value, even three or four times greater, than the sum he had himself inherited". This is his answer to those who would object that the rates under the plan are confiscatory and would check individual enterprise and saving.

We are not concerned here with the Rignano plan as a project which would transfer the title of wealth to the State, although that was the main object which the author had in view. In his words, it was a "painless transition to socialism". It must be judged from the point of view of its being a practical instrument for raising revenue, and it must be isolated from its socialistic object, and although not rigid in form it will be examined as enunciated in the quotation above. In some tax systems there is, in regard to income, a differentiation between earned and unearned or investment income. Why, then, should there not be in death duties a differentiation between earned wealth (*i.e.* acquired by work and saving) and unearned wealth (*i.e.* acquired by inheritance or gift)? Could not the scheme be isolated from its socialistic covering and examined purely as a method of taxation? Could it not be put in a form agreeable to the tax payer by a limited discriminatory tax, for example, by doubling the tax on the value of that part of the testator's estate which he inherited from others? Is this not advisable when in some countries and in the states or provinces of these countries the limit of existing progressive rates has been reached? As in some cases when a succession occurs within five years a deduction of estate duty is allowed, and this without much difficulty, why should this not be extended so that it may be possible administratively to separate out all the prior wealth of the testator? Where an estate duty does not exist would it not be administratively practicable to add to the succession tax such an estate duty discriminatory in regard to inherited wealth?

In support of the tax it is urged (1) that it would stimulate thrift and enterprise; (2) that it conforms to the canon of equity; and (3) being productive it would be useful as a method of redeeming public debt. On the other hand, it is said (1) that the chances of evasion are very great; (2) that it lacks the means of adapting changing values to the values of estates inherited; (3) that it would take a considerable time before it could come into operation; and (4) that the tax would be costly to collect. In short, on the score of practicability it must be held to be unworkable, and no inheritance tax has so far embodied this proposal. It is necessary, therefore, to examine the pros and cons of the proposal. It goes without saying that the attitude of the tax payer varies in each country to such taxation, and historical as

well as psychological factors have to be considered. One country, too, may have in operation a sound and workable system of death duties which it would be unwilling to scrap or to alter to fit in with the Rignano or any similar scheme. The Board of Inland Revenue and the Committee on National Debt and Taxation examined with care the Rignano scheme of death duties, and the results of their inquiries are of considerable value on theoretical as well as on practical grounds. The Board of Inland Revenue examined the proposal as given in the quotation from Rignano above and found it to be not impracticable. It stressed the first, third, and fourth objections to the tax. "Special provisions", the Board said, "would be required as to the disclosure of gifts, and drastic penalties for non-disclosure would have to be imposed. Even with such provisions, the incentive to, and the opportunities for, evasion would be considerable. Joint investments and joint banking accounts would also afford means of evasion which it would probably be very difficult to control." It would take, say, two generations before "the tax would approximate to the standard prevailing in the case of the other main direct taxes", and "any such scheme would necessitate the keeping of very elaborate and costly records".¹ The chairman of the Board held that the Rignano scheme must largely depend on the tax payer's attitude and that it would be easier to work if there were two rates only—one for wealth accumulated during lifetime by the testator's own efforts and the other on property inherited or received by gift. The Committee on National Debt and Taxation examined the project from all points of view. In regard to the effect on savings the Committee was of opinion that it must first win the approval of the tax payer before it could be advantageous to savings. At the same time the low rate on wealth saved would be an incentive to work. The owner, however, might squander away what he inherited, or at any rate take risks in investment that he otherwise would not do, and he would be much tempted to evade the tax by gifts *inter vivos*. These facts make it less easy to generalise as Rignano does on the certain impetus to saving which his scheme in his opinion is bound to give. It is not beyond the bounds of possibility for the testator to squander away so much

¹ Note by the Board of Inland Revenue, App. xxvi., appendices to the Report of the Committee on National Debt and Taxation.

of his property as not to leave even enough to pay for the inherited portion. The State under the scheme will presumably not enter into the history of each portion of the property. If the inherited portion is X and if this is lost in speculation and should the testator before death leave the equivalent of X + Y the State will measure the excess over X as the savings and X as the inherited property. In regard to the problem of changes in the value of wealth, Rignano suggested that alterations in the general value of money may have to be provided for by an index number and to permit of exceptions. To treat all inherited wealth as "settled" so that the principal could not be touched would in the long run be injurious. It is desirable that capital be free to go into channels where required. This part of the problem still requires further investigation in order to avoid inequalities to tax payers. The Committee came to the conclusion that after careful inquiry the Rignano scheme had possibilities, but these "had not yet been embodied in a form promising reasonably fair treatment to the individual tax payer, while the administrative problems are very formidable and the risk of evasion is serious. Some of us, however, find the principle in itself attractive and think it possible, from such consideration as we have been able to give to the idea, that it may in course of time have useful developments and enable some improvement to be effected in the existing death duties system."¹ The Committee subjected the Rignano scheme on the whole to too severe a test, especially with regard to equity and evasion and also, although to a less degree, difficulties of administration from the point of view of Great Britain. There does not seem to be any insuperable objection to the levy of a compound form of duty, limited in its discriminatory effect as for example, the duty on wealth saved being half that on property inherited or gifts received during lifetime. The danger of evasion may be avoided to some extent by watching income tax returns which show in any year a considerable rise from property. The plan is more suitable to an estate duty than to an inheritance or share tax but is applicable to both. It requires, above all, the support of the general body of tax payers before it can be introduced, and that in some countries is likely to be a difficult matter.

A cleverly devised variation of the Rignano plan is that

¹ Cmd. 2800, 1927, p. 316.

which levies, when the estate passes at death, an ordinary duty and, in addition, a second duty. In return for the second duty the State would pay the inheritor an annuity terminable at death or after a stated number of years. This additional duty is to be levied, not as in the Rignano plan at the second transmission, but at the first, and in this respect it fails somewhat to preserve the distinction of Rignano between saved and inherited property. The inheritors would not lose in immediate income, but "They would be holding a wasting asset in place of a permanent source of income". The State would gain on the expiry of the annuity. The advantage of this variant on the Rignano scheme is that it would avoid some of the difficulties, especially administrative difficulties, connected with Rignano's proposals, such as the problem of changing values and compulsory settlements. It is also urged that it would encourage inheritors to save as the annuities would run out and it would be essential to make good the future loss of income. The Committee on National Debt and Taxation examined this project from the point of view of the British death duties and also as a means of debt redemption. It seems doubtful whether it would stimulate inheritors to save because in many cases the inheritor would regard the tax as if it were a direct tax on capital, and he may sell his annuity to recoup himself, while the improvident inheritor would almost certainly regard the annuity as income and would spend all the more. The annuity, moreover, never a popular form of investment, would be less in value than its value according to tables, and would be a greater burden on the tax payer than the actuarial equivalent of an ordinary tax. It would not be easy to work in regard to gifts *inter vivos* in view of legal and administrative difficulties that would arise. Until the annuities ran out the State, as already noted, would not gain. The Committee agreed with the Controller of Finance H.M. Treasury that the burden on the payer or beneficiary was probably heavier than the advantage which the State would get out of the transaction, and that it gave less immediate assistance to debt redemption, and in a less convenient form, than the ordinary death duties.¹

¹ *Public Finance*, by Hugh Dalton, M.P., Under Secretary of State for Foreign Affairs (1929, p. 116); cf. Cmd. 2800, 1927, pp. 317-318. Henderson, *Inheritance and Inequality*, pp. 17-26. The scheme examined by the Committee referred to above was that of Dalton, who proposed that the second duty should be payable in cash, in Government or other approved securities, or in any

VI. DEATH DUTIES OR INHERITANCE TAXES IN FEDERAL CONSTITUTIONS

7. In Federal constitutions the imposition of death duties raises the question whether these taxes should be levied by the Federal or Central Government, by the State or Provincial Governments or by both. In Germany, South Africa, and in all Federal Latin American states possessing this form of taxation, Mexico excepted, such death duties are Federal. In Switzerland, Canada, and Mexico these are State and not Federal, while in the United States and Australia there are Federal and State duties in existence. In Germany an estate duty was given up in 1922, and succession rates which vary according to relationship and according to the amount of the estate received by the beneficiary are now so small a part of the Federal revenue—less than 1 per cent—that they are almost not worth the cost of collection. In 1924 a law was passed which reserved these duties entirely for the use of the Federal Government. In the Union of South Africa the Cape Province, Natal, and the Transvaal had death duties of their own, but the Union Death Duties Act of 1922 consolidated and uniformed the estate duty and succession taxes, and the proceeds were assigned to the Federal authorities. In Switzerland the cantons levy these duties, which vary considerably from canton to canton. A Federal inheritance tax for the purpose of financing old age and sickness insurance throughout the Federation was proposed, and it was also proposed to divide the proceeds of the duties between the Federal Government and the cantons equally. In 1921 the proposal was shelved until at some future date social insurance plans should have matured. In all the provinces of Canada there are succession duties, and these duties are relatively of greater importance to the total Provincial revenue than in any other Federal Government of the world. There is no Federal estate or succession duty. Until 1916 in the United States the taxation was—except during the early years of the Republic (1797–1802), the Civil War, 1862–1870, and the Spanish-American War in 1898–1902—a State or commonwealth tax. The Act of 1916 gave the Federal Government the power to levy an estate duty which is now a permanent part of the tax

other form acceptable to the Government. This would give rise to administrative difficulties and certain risks, especially on the selling of land.

system, although originally it was supposed to be a War-time measure. In forty-seven states of the Union there are succession or share taxes and supplementary estate duties in Rhode Island (1916), Mississippi (1918), Oregon (1919), and New York (1925). The American National Tax Association, it is interesting to note, has always strongly favoured the use of an inheritance tax, although not as a Federal but as a State tax, while writers and thinkers on American finance have, especially since 1916, favoured a Federal tax. Thus Seligman in his later works¹ champions a

INHERITANCE TAXES IN FEDERAL COUNTRIES

Country.	Year.	Inheritance Taxation, Millions.	Total Taxation, Millions.	Percentage of Inheritance to Total Taxation.
Germany .	1932-33	Federal R.M. 62	R.M. 5042	1·2
South Africa	1933-34	Federal . £0·8	£22·7	3·5
Switzerland	1933	Cantonal Fcs. 17·6	Fcs. 278·1	6·3
Canada .	1932-33	Provincial \$13·1	\$94·4	13·8
U.S.A. .	1931-32	Federal . \$47·4	\$1557·7	3·0
		State . \$144·0	\$1641·9	8·8
		Total . \$191·4	\$3199·6	6·0
Australia .	1933-34	Commonwealth £1·5	£56·4	2·7
		State . £3·7	£34·4	10·7
		Total . £5·2	£90·8	5·7

Federal inheritance tax because the needs of the Federal Government are relatively greater as compared with the states, and at the same time the Federal Government must not interfere with the sources of tax revenue belonging to the states. He adds three other arguments : (1) that "the Federal inheritance may be made to solve the problem of uniformity of taxation"; (2) that a Federal estate tax reaches both Federal and local tax exempt bonds; and (3) states, unlike the Federal Government, are unable to negotiate with foreign governments under the constitution to avoid difficulties of international double taxation. "We have", he adds, "a defective law and a still more defective administration. With an improved law, with the enforcement of the gift tax, with the rendering impossible the evasion of the inheritance tax through our absurd incorporation of individuals, and with a proper kind

¹ E.g. *Studies in Public Finance*, New York (Macmillan Company), 1925, p. 175.

of administration, we should soon find that our revenues would be greatly augmented, even though the rates were diminished. With a revenue of several hundreds of millions, it would then be possible to hand over to the states a portion of the yield, whether it be 25 per cent or 75 per cent, with the result not only that the Federal Government would get more than at present, but that the states would secure as much as they now receive or could in the future secure through independent action."

In the foregoing table the relative importance of Federal and estate inheritance taxes is shown. The large percentage in the case of Canada is particularly striking. In non-Federal countries the percentage of death duties to total tax revenue was about 12 per cent in Great Britain (1933-34), 5.4 per cent in France (1926), 2.6 per cent in Japan (1933-34), and 1 per cent in Italy (1933-34).

Inheritance taxes in the new Indian Constitution have been provided for. They have not so far been levied. The administration of these taxes other than land will be vested in the Federal Government and the proceeds will be assigned to the provinces, the basis of distribution being determined by the Federal Legislature with a right to impose and retain a surcharge on such taxes for Federal purposes. Death or succession duties on land are a provincial source of revenue.

It is difficult to lay down a definite principle applicable to all countries of a Federal nature. Historical considerations and the needs of the Government at the centre as well as state or provincial governments have to be considered. The old doctrine of the division of sources—indirect taxes being levied by the Federal Government and direct taxes by State Governments—is as dead as the dodo. Federal Governments have at the present time, and will continue to have, large expenditures to meet. State governments, too, as in the United States and India, have large commitments, especially in connection with education and other essential national services. Expenditure of the Federal Government in the former has increased 444 per cent as compared with the pre-War year, as the table on the following page shows.

There is some justification for the view that revenue is greatly needed by the several states and that, therefore, inheritance taxation should be left to them. On the other hand, if this is considered from a wider financial point of view it will be found,

as American experience has proved, that inequality according to situs and domicile will result. There is very little in the argument that Federal inheritance taxation permits of evasion to a greater extent than state inheritance taxes. Indeed, administratively the Federal tax is not infrequently collected more efficiently and more cheaply, and is accompanied to a less degree by such dangers as have been mentioned, including double taxation which in times of high taxation is of no small importance. The income tax (collected centrally in British India) could never be administered so efficiently as it is under the Federal or centralised system where the Central Board of Revenue has its own Commissioners of Income Tax in each province and its own agents

	In Millions of Dollars.*		Percentage Increase
	1913.	1925.	
Federal	692	3765	444
State : : :	383	1530	299
Local	1844	5829	216
Total	2919	11,124	281

* Source : The Cost of Government in the United States, 1925–26 (National Industrial Conference Board, New York, 1927).

locally. Were each province alone to levy a tax it could not be done so cheaply and so efficiently as the centralised tax. Similarly when an inheritance tax in the form of both an estate duty and a succession or share tax is introduced generally in British India it will be a centralised Federal tax apportioned to the provinces. Such a tax when Federal acts like a tonic to the collection of all taxes by the states. It braces states and provinces to better things, to the collection of taxes on more efficient lines and thus they are protected against their own failings. The instance of the United States is a case in point. In some federations the revenue from death duties is relatively far too low as compared with income tax and the national income of the country. In the United States, for example, death duties (Federal and State) in 1925–26 were but 9 per cent of the income tax (Federal and State) and 9·4 per cent in South Africa as compared with 17·8 per cent in Australia in the same year. The income, however, of the United States is 27 times greater than that of Australia and 92 times that of South Africa. Death duties in Great Britain

amounted in 1927-28 to £77 millions, or about twice the amount of inheritance taxes in the United States for the same period, although the population of the former is only about one-third and the total national income only a little more than one-fourth of that in the United States. It should be possible, therefore, to raise considerably the proportion of the tax revenue from inheritance taxation in the United States and to collect it federally, as suggested by Seligman and others, with great benefit to the states.¹ All things considered, a Federal tax—an estate duty and a succession or share tax—should be levied wherever possible, and a share of this made over to state or provincial governments. This means simplicity and the avoidance of many pitfalls, the result of the more complicated system of Federal and State collections, and should be easy if there is administrative machinery (for example, for the collection of a Federal income tax) already in existence. Efficient administration would bring increased returns, without even any increase in existing rates, even in those federations where these are unduly low. The Federal authority may permit the provincial or local governments to impose an additional tax if required for local purposes, or it may permit these authorities to tax below the minimum fixed for the Federal inheritance tax. This, however, should be the rule rather than the exception. An apportioned tax on a uniform basis, however, is preferable in these days when in Federal finance co-operation is all important both from the national and the state or provincial point of view. The Federal authority may administer the tax and have the right to place a surcharge when necessary on the proceeds (which go to the Units).

VII. DEATH DUTIES IN GREAT BRITAIN

8. Death duties in Great Britain² are derived from two main sources, (*a*) estate duty which is a transfer on property, the State

¹ Cf. Seligman, *Studies in Public Finance* (Macmillan Co., 1925, p. 175).

² *The Death Duties*, R. Dymond (London, Solicitors' Law Society, Ltd., 3rd edition, 1920). (A systematic work.) *Practical Guide to the Death Duties and to the Preparation of Death Duty Accounts*, C. Beatty (London, Effingham Wilson). (A short manual.) British Death Duty Acts, 1796-1926; Soward and Scott, *Law and Practice of the Estate Duty*; Soward and Willan, *The Taxation of Capital*.

The annual Reports of the Commissioners of H.M.'s Inland Revenue contain the statistics showing the analysis of realty, personality, etc.

taking a percentage of the net value on the death of the owner; and (b) legacy duty and succession duty, which may be regarded as an acquisition duty payable by a beneficiary or beneficiaries on acquiring property. These duties are a growing source of direct taxation and can also be budgeted for with tolerable accuracy, even allowing for "windfalls" that may accrue from very large estates being subject to duty in any year.

Death duties were in 1933-34 12 per cent of the total tax revenue or 10·5 per cent of the total revenue receipts.¹ By far the greater portion is derived from the estate duty. Thus for the year ended 31st March 1934 the net proceeds were approximately £85 millions, and were made up as follows: Estate duty £75 millions, or 88 per cent of the total; legacy duty, £8,632,000,

Year ended 31st March.	Budget Estimate (£ millions).	Net Receipts (£ millions).
1914 27	27	
1919 32	31	
1922 * 48	53	
1923 48	56	
1924 52	58	
1925 56	59	
1926 67	61	
1927 66	67	
1928 68	77	
1929 72	81	
1930 81	79	
1931 83	83	
1932 83	65	
1933 76	76	
1934 75	85	

* Great Britain and Northern Ireland since 1922.

or 11 per cent; and succession duty, £1,110,000, or 1 per cent. Death duties yielded £81 millions in 1934-35 as compared with £85 millions in the previous year.

The estate duty is an *ad valorem* progressive tax levied on the value of all immovable or movable, settled or unsettled property in Great Britain which passes upon the death of any person. It dates from the Finance Act, 1894,² and the father of the tax was

¹ *Vide Table IX. App.*

² Exactly 200 years previously (*i.e.* 1694) a tax, copied from Holland, in the form of a stamp duty was imposed upon probate or letters of administration for any estate above the value of £20. This came to be known as probate

Sir William Harcourt, Chancellor of the Exchequer in Lord Rosebery's Government. Harcourt belonged, in the words of his biographer, "to the old tradition of statesmanship which regarded a rigid public economy as the first essential of good government. He believed that an extravagant and wasteful habit of expenditure corrupted the public service, and had subtle reactions on policy, especially where the demands of the war departments were concerned. But it was not the spending of the national resources that furnished his chief interest in the subject. He had long been conscious of the anomalies of taxation, especially in regard to the land. A member of a landed family himself, he had early broken with the views of his class in regard to the special privileges with which a legislature, then chiefly controlled by the landed interest, had invested real estate, and the political disagreement with his brother at Nuneham had turned mainly upon this theme."¹ The introduction of Harcourt's proposals raised in some quarters considerable criticism and even opposition. The Conservative viewpoint is well expressed in a letter² to the Chancellor of the Exchequer from Her Majesty, Queen Victoria, who wrote from Balmoral Castle on 5th June 1894 as follows :

The Queen is much concerned about the provisions made in the Budget regarding the death duties, which, in her opinion, cannot fail to cripple all landowners. Many properties are now only kept afloat at considerable loss to the proprietors, who, if the Budget becomes law, may be driven to still further curtail their expenditure. This must inevitably affect the poorer classes, especially the agricultural community, numbers of whom will be thrown out of work altogether. Then again country-seats will be unoccupied and charities throughout the country be denuded of support. Where, again, will be the inducement to owners of property to effect improvements, when by so doing they know they are only encumbering

duty. It was increased to 10s. in 1698, and North, in 1779, introduced three scales with reference to the value of the property (cf. Dowell, vol. iii. p. 148). This reform was modified to meet the financial exigencies of the State from time to time till 1889, when the duty was fixed at 3 per cent *ad valorem*. These duties did not, of course, include real or settled estate. For 200 years, therefore, real property escaped this form of death duty. Death duties were a source of revenue in England to its kings for nearly six centuries. After the Norman conquest to the Civil War there was in effect a succession tax levied by the king through the *inquisitio post mortem*. The supervision of this revenue was under the Court of Wards and Liveries set up by Henry VIII. and abolished in the reign of Charles II. (cf. Dowell, vol. i. p. 20).

¹ *Life of Sir William Harcourt*, A. G. Gardiner, vol. ii. p. 281 (London, Constable), 1922.

² *Op. cit.* Vol. II.

their successors—possibly their widows, who, the Queen fears, are also placed in a worse position than before by the proposed death duties. This leads the Queen to remark that she has always deplored the action of the probate laws which subjects widows and nearest of kin, at the time of deep sorrow, to an immediate minute examination and valuation by some strangers of their private possessions, which she thinks is painful and cruel. Most earnestly does the Queen urge and hope that Sir William Harcourt may be able to modify these proposals, which she owns she thinks dangerous.

To this Sir William Harcourt as Chancellor of the Exchequer wrote to Queen Victoria on 9th June 1894 as follows :

Sir William Harcourt presents his humble duty to Your Majesty, and begs leave to report that in the last few days solid progress has been made with the clauses of the Budget Bill in Committee.

Sir William desires to assure the Queen that the outcry which has been made by the landed interest on the subject of extraordinary pressure upon them in the Budget is grossly exaggerated if not entirely unfounded. Lord Salisbury's statement that it will absorb four years' income is entirely contrary to the fact. In the case of a man with £100,000 the additional taxation will be 1 per cent, and in that of a man with a million, 4 per cent, and in the case of the last it might amount to two years' income payable in eight years. The truth is that the landowners have been so long accustomed to exemption from their fair share of the taxation borne by the other classes of the community that they resent as a great injustice that they should be treated on an equal footing.

It is no doubt a great misfortune that owing to the immense expenditure upon armaments it should be necessary to raise an additional sum of 4 millions by taxation, but that can only be done by imposing the burthen equally upon all classes, with a regard to the ability of the several parties to bear it.

Sir William believes that the great support which the Budget has received in the House of Commons, and still more outside, far beyond the Party majority which the Government can command, is due to a conviction that it is an honest attempt to distribute the burthen fairly and justly amongst all classes of the community.

Of the sum to be raised not one-fourth part will be asked of the landed interest ; the rest will fall on the personal property ; and yet it is those who will contribute least who complain most.

It is true the land is now in a distressed condition, but it will only pay in proportion to what it received. Other industries are also depressed, but they do not make that a pretext for refusing to pay their share in the public burthens necessary for the defence of the country.

It is a sense of the justice of our demand that gave the Government a majority of over 100 in the division on the question of graduation.

It is quite impossible to raise large sums of money without inconveniencing some one, but no class—and least of all those who are the loudest in their demands for augmented expenditure—ought to refuse to bear their part in the necessary sacrifice.

Sir William is extremely anxious to remove any particular hardships which may arise in the case of the land, and has already opened communications privately with the Opposition to see if it is possible, consistently with the necessities of the public service, to meet their views.

Immovable property in Great Britain is liable to estate duty but not immovable property abroad. By immovable property is meant lands and houses and all interests therein, including leasehold interests. Movable property in Great Britain is also liable to estate duty, and this includes goods, furniture, stocks, shares, and securities. Movable property outside Great Britain is chargeable only when the deceased was the owner and domiciled in Great Britain, or when he had only a life interest, and at his death the movable property became a British trust or vested in a British trustee. Gifts made *inter vivos*, unless made more than three years before death, and gifts made for public or charitable purposes, unless made more than twelve months before death, are liable to estate duty. So are moneys receivable under insurance policies on the life of the deceased, effected and kept by him wholly or partially for the benefit of a donee. Marriage gifts, however, gifts proved to be part of one's normal expenditure, and gifts not exceeding £100 in value in the case of any donee, are excluded. The net principal value of the estate is arrived at by taking the total of the principal values of all the items of property, less deductions for reasonable funeral expenses and subject to certain reductions for debts and incumbrances of the deceased. The principal value of the property is the price which the Commissioners of Inland Revenue believe the property to be worth if sold in the open market at the time of the death of the deceased. Small estates up to £300 and £500 pay fixed duties of 30s. and 50s. respectively, and are exempt from all other death duties. Interest at 3 per cent per annum is payable on personalty from the date of the death up to the delivery of the affidavit or accounts. On real property the duty may be paid by eight yearly

or sixteen half-yearly instalments, and that on certain annuities in four yearly instalments. Interest is charged on all unpaid portions of duty from twelve months after death at the rate of three per cent per annum. Exemptions from estate duty include (1) estates of a net principal value not exceeding £100; (2) the property of common seamen, mariners, soldiers, or airmen who are killed or die in His Majesty's Service; and (3) certain articles which are ascertained to be of "national, scientific, historic, or artistic interest". In order to avoid the double taxation of movable property in a British Dominion, movable property pays only so much duty as is equal to the larger of the two taxes. The amount of duty payable in the Dominions is thus deducted from the amount of estate duty due in Great Britain.

The rates of estate duty are set out in the following table. The progressive nature of the duties is obvious, especially on the higher incomes. Thus on £1,000,000 38 per cent estate duty is payable. A further sum, as we shall see, is payable for legacy duty varying from 1 to 10 per cent. Gifts for public or charitable purposes are subject to estate duty unless made more than a year before death; other gifts are charged unless made more than three years before death. Gifts not exceeding £100 in value, marriage gifts, or gifts as part of the decedent's normal expenditure are excepted.

SCALE OF RATES OF ESTATE DUTY

	Principal Value of the Estate.		Rate per cent of Duty.
Exceeding	£100 and not exceeding	£500	.
"	500 "	1,000	.
"	1,000 "	5,000	.
"	5,000 "	10,000	.
"	10,000 "	12,500	.
"	12,500 "	15,000	.
"	15,000 "	18,000	.
"	18,000 "	21,000	.
"	21,000 "	25,000	.
"	25,000 "	30,000	.
"	30,000 "	35,000	.
"	35,000 "	40,000	.
"	40,000 "	45,000	.
"	45,000 "	50,000	.
"	50,000 "	55,000	.
"	55,000 "	65,000	.
"	65,000 "	75,000	.

SCALE OF RATES OF ESTATE DUTY—*continued*

Principal Value of the Estate.	Rate per cent of Duty.
Exceeding £75,000 and not exceeding £85,000	18
" 85,000 " " 100,000	19
" 100,000 " " 120,000	20
" 120,000 " " 150,000	22
" 150,000 " " 200,000	24
" 200,000 " " 250,000	26
" 250,000 " " 300,000	28
" 300,000 " " 400,000	30
" 400,000 " " 500,000	32
" 500,000 " " 600,000	34
" 600,000 " " 800,000	36
" 800,000 " " 1,000,000	38
" 1,000,000 " " 1,250,000	40
" 1,250,000 " " 1,500,000	42
" 1,500,000 " " 2,000,000	45
" 2,000,000 " "	50

Legacy and succession duties are complementary owing to their history. The legacy duty is levied on movable property devolving under the will or intestacy of a person domiciled in Great Britain. The movable property wherever situate is liable to duty if the deceased owner was domiciled in Great Britain. If the testator or intestate was not domiciled in Great Britain the property is not liable to legacy duty. All settled movable property, wherever situated, is liable to succession duty if the forum of administration was in Great Britain. But if it was the subject of a non-British trust it is not liable to duty. Immovable property outside Great Britain is not liable to duty under any circumstances. The rates of legacy duty and succession duty are as follows: 1 per cent in the case of a husband, wife, child, or lineal descendant of child, father or mother, or any lineal ancestor; 5 per cent in the case of brother or sister, lineal descendant of brother or sister; and 10 per cent in the case of any other person, including any related only by natural ties. The duties are payable when the beneficiaries become entitled to the benefit, but in certain circumstances both duties may be paid by instalments, extending in the case of real property to a maximum period of 8 years. The legacy duty dates from 1780, and in 1796 an Act was passed "in respect of the acquisition by collaterals and strangers of property through the testacy or intestacy of its

deceased owner". The Act of 1796 is in the nature of a tax on beneficiaries, and is still on the statute book. In 1853 a succession duty, also a tax upon beneficiaries, was imposed upon real property and also on settled movable property not liable to legacy duty. No legacy duty is chargeable when the gross value of the personal estate is under £100; and no succession duty is chargeable when the principal value of all the succession is under £100. No duty of either sort is charged in respect of objects not yielding any income. Duty, however, becomes payable if and when the same are disposed of or pass to anyone who has a power of sale or disposition. National, scientific, historic, or artistic objects are not taxed except when sold, and then only in connection with the last death on which they passed. Exemption is given to the National Gallery, British Museum, or other similar national institution, or to any University, County Council, or Municipal Corporation in Great Britain, or to the National Art Collections Fund. There are certain exemptions and reliefs in regard to legacy and succession duties. Neither legacy nor succession duty is chargeable on benefits where the net value of the property passing in respect of which estate duty is payable does not exceed £1000. Exemptions are allowed when the value does not exceed £15,000 and when property passes to a lineal ancestor or descendant or an individual chargeable at 1 per cent rate of duty. Where the beneficiary is the widow or child under the age of 21, and if the value of the benefit passing does not exceed £2000, no duty is leviable.

VIII. THE DOMINIONS

9. In the self-governing Dominions, death duties or inheritance taxes are on the statute book.¹ According to section 92 (2) of the British North America Act, 1867, the succession duties are levied only by the provinces in Canada. The tax first levied by Ontario, Quebec, Nova Scotia, and New Brunswick in 1892 was introduced by other provinces gradually and forms, as we have seen,² one of the important sources of revenue for the provinces. There is a family likeness among the Acts, and the effect of the United States on Canadian provincial legislation is evident. In

¹ Prentice-Hall, *Inheritance Tax Service*, Prentice-Hall, Incorporated, 70 Fifth Avenue, New York. (A complete loose-leaf text of inheritance taxation in United States (Federal and Commonwealth States) and of Canada, kept up to date by periodical circulars.)

² See p. 522.

Ontario¹ and Quebec² the tax is graduated according to the value of the estate and according to relationship. In most of the provinces exemptions are given, and the tax is greater on collaterals than on lineal descendants or ascendants. Thus in Manitoba the rate of tax varies from 0·3 to 25 per cent according to the degree of relationship and to the amount of the estate. In 1934 there was a surtax of 15 per cent added to all duties. In Ontario the rate varies from 1 to 35 per cent according to the value of the estate passing to each beneficiary, and in New Brunswick the rate varied from $2\frac{3}{4}$ to 20 per cent according to the amount of the whole estate, the amount of each share and to relationship with the decedent. Since 1932 there was a 10 per cent surtax on all duties payable.

In Australia the Commonwealth estate duty which came into force in 1914 is similar to the British estate duty in that the tax is levied upon the total net value of the estate, real and personal. Estates below £1000 are exempt from the tax, and the estates between £1000 and £2000 are taxed at a rate of 1 per cent increased by 0·2 per cent for each additional £1000 of the estate and reaching 15 per cent on estates of £75,000. After this limit the rate is stationary. Bequests to religious, scientific and charitable organisations, as well as the estates of persons killed in the War are exempted. A deduction equal to one-third of the tax is granted on that part of the estate passing to the widow, children, and grandchildren of the decedent. In the States of the Australian Commonwealth similar exemptions are granted. Thus in South Australia exemptions to a widow, widower, descendant or ancestor are given in respect of individual successions under £500, and the rates are graduated into three groups with a half-rate in the case of widows or children under 21 where the net estate of the decedent is under £2000. In 1934 there was a super-tax of 25 per cent. In the New South Wales Act a distinction is made between those of local domicile and those of foreign domicile, the rates of the latter being heavier than on the former. In Tasmania rates are graduated from 3 to 15 per cent. The term "succession duty", however, does not mean the same as a succession duty levied upon the interest of each beneficiary in all the States. Thus in Queensland there is an estate duty on the whole estate, and an additional tax (graduated according to the total value of the estate) is levied upon the beneficiaries. This latter tax is called

¹ Succession Duties Act, 1907.

² Succession Duties Act, 1906.

a succession duty, although it is determined by the value of the whole estate. Where the total value of the estate passing to wife or lineal issue is below £500, no duty is charged. If it exceeds £500 but does not exceed £2500, one-half of the prescribed rate is charged. If it exceeds £2500 but does not exceed £5000, two-thirds of the prescribed rate is charged, and where the successor is not a stranger in blood but is other than the wife or husband or lineal issue, the duty charged is the prescribed rate plus one-half, but not more than 15 per cent. Where the successor is a stranger in blood, the duty charged is double the prescribed rates, but does not exceed 20 per cent. In Queensland, in short, there are two estate duties in reality, the so-called succession duty being 1 per cent more than the probate duty or estate duty proper. In South Australia, death duties, unlike those of other States, are in the form of a succession duty similar to that levied in Great Britain. Real property in South Australia and personal property, wherever situated, are dutiable if the deceased person was domiciled in South Australia. Duty payable outside the State on any property not situated in South Australia may be deducted from the duty payable thereon in South Australia.

In Queensland probate duty is charged in respect of probate or letters of administration in respect of the Queensland estate of the deceased person, and is payable only on the personal estate which comes into the hands of the executor or administrator. Succession duty of a special nature is also levied according to the aggregate successions, with rebates on the shares of closer relations. In South Australia, death duty, unlike that of other States, takes the form of a true succession duty, as already noted. Death duties have long been an important source of revenue for the States which adopted in this field of taxation progressive rates sixty years ago, Victoria leading the way in 1870.

In New Zealand death duties were first levied in 1881 at a progressive estate duty from 2 per cent on the first £1000 to 10 per cent on the excess over £50,000. Four years later progression became steeper. Spouses, however, were exempted and strangers in blood had to pay 3 per cent in addition. In 1909 estate and inheritance legislation was passed, the rates in both taxes being progressive as hitherto. The estate duty valued from 1 to 15 per cent, and the succession tax included a discrimination according to consanguinity. Death duties are now levied in accordance with

the Act of 1921.¹ The estate duty ranges from 1 per cent on estates not exceeding £1000 in value to as high as 20 per cent on estates of more than £100,000, with an additional tax of 10 per cent on the excess over £100,000. The succession duty is also payable by the beneficiaries according to relationship. An exemption from duty is made in favour of charitable trusts, and special provision is made both in estate duty and in succession duty for widows and small estates. Thus if the final estate is not worth more than £10,000, any interest acquired by the wife up to £5000 is exempted from duty, but the rate of duty on the whole estate must be determined before the deduction is made. An exemption of £5000 is also allowed in the case of wife and lineal descendants or lineal ancestors of a soldier who has met his death on account of the late War. The succession duties vary from 1 to 20 per cent. An additional 10 per cent of the excess over £1000 is levied in respect of moneys payable to persons domiciled out of New Zealand, and where the beneficiary is not the husband or wife of the deceased or a relative of the deceased within the third degree of consanguinity. As compared with the rates in the Union of South Africa, the New Zealand rates are high.

Cape Colony had a succession duty prior to the Union Death Duties of 1922 which dated from 1864, which varied from 1 per cent on property going to ancestors or descendants of the deceased, 2 per cent to brothers and sisters, 3 per cent to nephews and nieces, and 5 per cent to others. In 1908 these rates were raised to 3, 6, 9, and 15 per cent respectively. The Orange Free State had an Act on similar lines, also from 1864. The Transvaal had an estate duty from 1871, and Natal a succession duty similar to that of the Cape from 1905. There is also the Union Act,² which provides for both the estate and succession duties on British lines and is applicable throughout the Union. The Act of 1922 superseded and consolidated the legislation up to then in force. An estate duty on the total estate of every person dying is charged at the rate of half per cent on estates up to £2000, and from £2000 to £3000 1 per cent, and on an ascending scale up to 17 per cent on over £75,000. The rate of duty upon the dutiable amount of succession is 2 per cent where the successor is a direct descendant or ascendant of the predecessor, 4 per cent where the successor is the brother or sister of the predecessor,

¹ No. 21 of 1921.

² Death Duties Act, 29 of 1922, amended by 31, 1925.

6 per cent where the successor is the descendant of the brother or sister of the predecessor, and 10 per cent where the successor is otherwise related to the predecessor or is a stranger in blood or is an institution. Provision is made for the valuation of the property when the succession consists of limited interests therein, and for the refund of a proportionate duty paid should the succession lapse and the interest pass to another. A succession accruing from any predecessor to his surviving spouse, and any succession accruing to any public institution of a charitable, educational, or ecclesiastical nature, or any succession accruing to any provincial administration or municipality or any other local authority are exempt from succession duty.

DEATH DUTIES IN INDIA

The Moghul emperors asserted their rights to inherit the estates of their official nobility and sometimes of their wealthier merchants. Bernier has preserved a letter from Aurangzeb to his father, the Emperor Shahjehan, a part of which reads as follows : “ We have been accustomed, as soon as an Omrah (noble) or a rich merchant has ceased to breathe, nay, sometimes before the vital spark has fled, to place seals on his coffers, to imprison and beat the servants or officers of his household until they made a full disclosure of the whole property, even of the most inconsiderable jewel. This practice is advantageous, no doubt ; but can we deny its injustice and cruelty ? ” Aurangzeb, however, did not give up the practice during his reign. The yield from this source was immense—amounting to 19 karors (crores) of rupees¹ on the death of Asaf Khan in 1641. In regard to officials, this confiscation may be said to have been part of their contract of service, and it is only fair that the State should take what they had accumulated by their rapacity. In regard to merchants, however, this system must have handicapped trade and industry considerably.²

¹ This is probably an exaggeration, but it shows how productive the windfall was. The Zamorins of Calicut imposed death duties on the value of the Mohammedan landholders' estates at a rate of 25 per cent. Some of the Indian states (*e.g.* Bikanir, Indore, Bhawalpur, and certain of the states of Western India) have their own death duties. Bikanir, for example, levies an estate duty at a rate varying from $2\frac{1}{2}$ per cent to 20 per cent according to the relationship of the beneficiary to the decedent.

² Quoted by Moreland in *Akbar to Aurangzeb*, London, Macmillan, 1923.

In India at present there are no estate or succession duties. There are, however, certain small fees which up to 1910 were levied at a flat rate of 2 per cent on the value of property exceeding Rs.1000, collected under the Court Fees Act of 1870, when probate and letters of administration are granted to an executor or administrator. By the Act of 1910 (Act VII.) the rates were graduated 2 per cent on properties valued between Rs.1000 and Rs.10,000, $2\frac{1}{2}$ per cent between Rs.10,000 and Rs.50,000, and 3 per cent on property exceeding Rs.50,000. Since then in certain provinces the rates have been raised, as for example, to 5 per cent in Bengal, Bihar and Orissa, and Assam, and to 7 per cent in Bombay. Where there is no will, it is unnecessary to take out letters of administration except in one instance. Where there is a will, it is necessary to take out probate or letters of administration as the case may be, before the will can take effect.¹ Moreover, Indians, especially Hindus, generally do not make wills. The necessity of obtaining revenue from estate and succession duties is obvious to-day when Provincial Governments are faced with the duty of introducing free and compulsory primary education, and also the

¹ The law on the subject at the present time is briefly as follows : The Indian Succession Act of 1865 provides that, in the case of Parsees and Christians, probate and letters of administration have to be taken out when a claim has to be established in a court of law. Under the Hindu Wills Act of 1870, as amended by Section 154 of the Probate and Administration Act of 1881, Hindus, Sikhs, Buddhists, and Jains who, residing in Bengal and in the towns of Madras and Bombay, desire to establish a claim as executor or legatee in a court of law, have to take probate or letters of administration in respect of wills and codicils made in these places. If wills and codicils are made outside those areas, and if they refer to immovable property within those areas, probate and letters of administration have also to be taken. If claims have not to be established in a court of law, the taking of probate and letters of administration is optional. The Succession Certificate Act of 1889 applies to all outside the presidency towns of whatever community when the deceased ordinarily resided at the time of his death within the jurisdiction of a district court, or, having no fixed place of residence at the time of his death, left property within the jurisdiction of a district court. Succession certificates are granted to facilitate the realisation of debts and the transfer of securities, but are unnecessary unless a suit has to be instituted and a decree to be obtained. Banks, however, as a matter of practice, require a succession certificate. Section 9 of the Administrator-General's Act of 1913 provides that letters of administration shall be taken by the Administrator-General under certain circumstances, but this section excludes Indian Christians, Hindus, Mohammedans, Parsees, Buddhists, and those exempted by the Governor-General in Council under Section 332 of the Indian Succession Act of 1865. The effect of all the legislation is that probate, letters of administration, and succession certificates are taken only by a small portion of the population of India.

duty of performing other social services which will increase the productivity of the major portion of the population of the poorer classes. Up to the present time the financial aspect has scarcely, if ever, been raised, and it is only since the War that this question has come into prominence. "A tax on succession or on acquisition by survivorship in a joint family" was included as a provincial tax in the Reforms which came into operation in 1921-22. The application of this overdue tax was thus contemplated, but has not yet been introduced into or passed by any legislature.

The question may be considered from two points of view : (1) The making of all successions liable to taxation. In regard to this, the difficulty of the joint Hindu family system, where there is no inheritance, joint family property being acquired by survivorship and not by succession, will have to be examined. (2) The imposition of an estate duty on the property as a whole at the time when it passes from the dead to the living. All families would be liable to this duty, including (a) non-joint Hindu families, and (b) joint Hindu families, on the share of the deceased ancestor or coparcener, including that of his direct descendants.

The best method to make all successions liable to taxation as in the self-governing Dominions and in most other countries is (1) to levy a succession duty¹ on every person inheriting by will, succession, or settlement taking effect on the death of the settlor. Property below a minimum amount, say Rs.1000, may be exempted. The duty would be leviable on real and personal property. Unless there is an efficient administrative staff the duty on personal property may be evaded without difficulty. (2) Where the beneficiary who succeeds is a husband or wife of the deceased or is a lineal descendant or ancestor, a lower rate of duty may be levied than in the case of collaterals or strangers. Nearer relations should be taxed at a lower rate than more distant relatives, and a much higher rate of progression should be intro-

¹ A succession duty cannot be considered objectionable, not even on grounds of expediency. It is no reason to urge that the joint family is similar to a corporation which never dies, in spite of the death of a particular member of the family, and on this account should not be taxed. A great deal has also been made of the fact that there is plurality of heirs recognised by law in India. This makes the imposition of the tax little more difficult than otherwise it would be, but in course of time it would not be at all difficult or expensive to collect, owing to the lack of uniformity in classification of heirs. No reform is more overdue in Indian finance than the introduction of a considered scheme of inheritance taxation which should be federally collected and apportioned to provinces on the basis of their relative taxable capacity.

duced than at present. (3) The person becoming liable to succession duty should be compelled by statute to report his liability within a specified time to the Collector or to a suitable revenue authority of the District in which the property movable or immovable is situated. As in Australia, France, and other countries, various maximum penalties for offences may be prescribed. Thus in the Commonwealth Estate Duty Assessment Act, which came into force in December 1919, penalties were prescribed for (a) the obstruction of any officer acting in the discharge of his duty under the Act or the Regulations ; (b) the failure or neglect to duly furnish a return ; (c) the refusal or neglect to attend and give evidence when required ; (d) the making or delivering (knowingly and wilfully) of any false return ; (e) the under-statement of the value of an estate with intent to defraud ; (f) the evasion of assessment or duty by fraud or wilful act, default, or neglect. The Act also makes the last two indictable offences, and prescribes a maximum penalty of £500 or imprisonment for three years. (Sections 46, 47, and 48.) Similar provisions suitable to India will be necessary. In some cases the penalty clause may be double the duty. Fictitious partitions or gifts in anticipation of death, *benami* transactions (*i.e.* nominal transfers), should be guarded against, and the three years' rule in Great Britain should be followed. When fictitious transfers are made within three years before the death of the transferor in order to evade payment of succession duty, such transferred property may be held liable to duty. Steps might be taken to see that partitions, gifts, etc., are *bona fide* and are acted upon. (4) The duty should be progressive, increasing with the value of the property just as the duty decreases with the nearness of relationship. (5) As real property will come largely under this, the administration of the Act may be entrusted to the Revenue Agency, but in order to ensure effective administrative control from above, and to secure uniform procedure and taxation in the different provinces, the Board of Central Revenue, New Delhi, must be entrusted with the care and management of the Act, as centralized administration is necessary even if the proceeds are distributed to the Units of the Federation.

It is necessary that the burden of the tax should be fairly distributed among the various communities, and this raises the difficult question of the joint Hindu family, where, so long as the family

remains joint, no individual member¹ has, with rare exceptions, any interest which he can dispose of by will. Property is acquired not by succession but by survivorship. Acquisition by survivorship in the case of joint tenancies in England to-day is subject to duty.² In England, however, on the death of a joint tenant the surviving tenant becomes entitled to the property, but the son of the deceased joint tenant has no claim whatever. In the case of the joint Hindu family system the male descendants of a deceased coparcener are themselves coparceners. The exceptions just referred to regarding testamentary dispositions are, in the words of Manu : "what one brother may acquire by his labour without using the patrimony, that acquisition made solely by his own effort he shall not share, unless by his own will, with his brother". Manu also exempts a present received on marriage or with the honey mixture.³ Thus a joint family is joint in regard to property, religion or worship, and joint in regard to the eating of food except when a brother has to live apart on account of his work in another place when a common mess is not possible, and even then the family still lives joint in property, religion, or worship, though not completely so in food. The two schools of Hindu lawyers—the Mitakshara and the Dayabhaga—differ in regard to the question of partition. According to the Mitakshara school, which is in force outside Bengal, the son immediately on birth becomes a co-owner or coparcener if he is within three generations, excluding the owner or the head of the joint family. These coparceners own the family property not as individuals but as a corporation. No single member possesses any ownership at all, except in self-acquired property as mentioned above. Under the Dayabhaga system the members of the family are owners of their undivided shares, and the sons take no interest in the family property in the lifetime of their father. Their interest, in short, is acquired by death and not by birth. Under the Mitakshara system, on the other hand, the interest of a coparcener varies

¹ A member of a joint Hindu family can claim as a right (1) partition if a coparcener, coparcenary being limited to males within three generations in unbroken male descent, excluding the head of the family, and (2) maintenance. A wife, for example, can claim from the joint family property only maintenance.

² Section 2 (1), b and d of the Finance Act of 1894, and Section 3 of the Succession Duties Act of 1853.

³ Cf. Mayne, *Hindu Law and Usage*, ch. viii.; Maine, *Early Law and Custom*, ch. viii.

with the death or birth of other coparceners. The share of a coparcener in Bengal is treated as individual property which may be liable for debts. The share of the Mitakshara coparcener cannot be seized for his separate debts unless a decree is obtained and the property attached during his lifetime.¹ The difficulty thus arising in the case of Mitakshara coparceners could be surmounted by finding out what the interest of the deceased in the property would have been if he had demanded partition just before his death. The question arises, why not tax the acquisition² of property by birth as well as by death? Every coparcener acquires an interest in the joint family property by birth. Again, the interest of the remaining coparceners increases by deaths and decreases with births in the family. If the interest which is increased by death is taxed, why not compensate diminution of interest by birth? If a duty is to be levied at the death of each infant coparcener, Hindu susceptibilities will be wounded, and the duty would constitute a real hardship owing to the frequency of the levy. Acquisition by birth may be left alone, as the object is to impose death duties. No compensation can be given for diminution of interest by birth, as compensation at birth and duty on death would tend to cancel each other, and the tax would then be unproductive. Moreover, there is no case at all for such compensation if we consider the question of equal taxation among different communities, e.g. Hindu, Mohammedan, Christian, or Parsee. Duties on the death of infant coparceners may, as will be seen later, be avoided altogether if the suggestion in the next paragraph is adopted. In order, then, to levy death duties on property acquired by survivorship, one of the following systems may be adopted.

The liability of the estate to duty may be limited to the occasion of the death of a coparcener of the oldest generation of the joint family. Thus in a family of three brothers and their children living in a joint family, succession duty would be payable only when each of the three brothers dies, and the

¹ A mere attachment of the property before judgment will not suffice (*Subrao v. Mahadevi* (1914), 38 Bom. 105). See also *Laxman v. Vinayak* (1916), 40 Bom. 329. Cf. Mulla's *Principles of Hindu Law*, p. 254 (Bombay, 1919). There is, however, an exception in the case of a father's legal and moral debts, as sons are under a pious obligation to discharge such debts even from their share in the coparcenary property. *Op. cit.* p. 236.

² This term is not intended to cover compensation for diminution by birth.

duty on each occasion would be on the amounts *aggregating* to one-third of its total value. The duty would not be levied on the death of any of the children, but only when one of the three brothers dies. If the three brothers die, and if there were five children and some grandchildren remaining, then succession duty would only be levied on the death of any of the five children, and it would be levied on each occasion on one-fifth of the total of the estate, and so on for each generation.¹ The advantage of this scheme is that it leads to equality of taxation among the different communities, Hindus, Mohammedans, Parsees, Christians, etc. A possible objection is that the tax is levied on a higher share than what a deceased coparcener would be entitled to. For example, to take an extreme case, when a Hindu dies leaving sons but no ascendants or collaterals, the whole property will be taxed and not merely the father's share. This is, however, not of importance in view of the fact that the equality of taxation among communities far outweighs any possible disadvantages that may result. The higher share referred to above does not mean that Hindus are taxed on a higher scale than others. It only aims at placing Hindus on the same footing as other communities.

Other possible methods are (1) to levy taxation only when the head of the family² dies, or (2) when the surviving coparceners all belong to a lower generation than the deceased coparcener. The first of these alternative methods may be given effect to by taxing either the whole of the property or the share that would have accrued to the head of the family if partition had taken place immediately before his death. The following example may be taken. Suppose A is one of three brothers, and if A dies the whole of the property will be subject to the tax. B then becomes the head of the family, and when B dies the whole of the property is again taxed. When C becomes the head of the family and dies, the whole property pays a tax for the third time. In England the property descends to the sons. In India, however, the property by survivorship

¹ The succession duty is not to be levied on the coparcener's share as a whole, but on the amounts by which the survivors are benefited. This in the aggregate will come to the share of the deceased coparcener.

² By "head of the family" in this proposal is meant a coparcener of the oldest generation of the family, and not any member of a lower generation, although the latter may look after the family affairs.

goes to the sons or brothers. In the latter case, therefore, this would tax the brother who dies not merely according to his share of the property, but according to the value of the shares of the remaining brothers and sons, or coparceners, which would mean in effect a heavier burden on the estates of Hindus than would, perhaps, be justified. If, on the other hand, the share of the deceased head of the family alone is to be taxed, a part of the property would escape taxation during each generation. For example, if C dies before A and B leaving sons, no tax will be levied as C is not the head of the family. On A's death one-third of the property will pay the tax. On B's death another one-third pays the tax, as he was the head of the family. Thus two-thirds of the property only pays the tax in a generation and C's one-third escapes taxation.

An alternative scheme is to tax property when the coparceners all belong to a subsequent generation than that of the deceased. Thus A and his sons B, C, and D form a joint Hindu family. A dies; B, C, and D pay duty on A's share. Subsequently B dies, but no duty will be paid as C and D belong to his generation. C's son E dies during C's lifetime. No duty is payable. The drawback to this method is that Hindus will be taxed less than other Indians because the tax is to be levied only when all the coparceners belong to a subsequent generation. It is suggested that to compensate for the fewer occasions on which the duty will be leviable a higher rate may be levied in such cases. This presupposes that it will be possible to arrive at the number of occasions on which the duty is not levied on the Hindu as compared with other communities. In the absence of this the fixing of a higher rate of duty will be somewhat arbitrary. All things considered, therefore, the first proposal seems to be suitable for adoption.

Another proposal is to levy in the first instance a succession duty on acquisition by legacy and by succession, but not by survivorship. It may also be feasible to extend the cases in which probate and letters of administration should be taken out, when a complete statement of accounts of the deceased's property will be required. In regard to the former this is only a half measure, and the second will not be an estate duty proper as levied in other countries.

Next with reference to the levying of an estate duty on pro-

erty in India passing on death by succession, survivorship, or settlement. For purposes of estate duty all property passing on death may be aggregated and treated as one. The liability to pay duty may be determined by gross assets, but the tax may be collected on the net value of the property, due allowance being made for liabilities. Arrangements may be made, as in Great Britain, Germany, Japan, Chile, and other countries, to reduce the amount of estate duty if it falls due within a short period after the payment of the previous duty. For example, when the second death occurs within one year of the first death the duty may be reduced by 50 per cent, and by an annual reduction of 10 per cent for each year down to 10 per cent when it occurs within five years of the first death. This reduction need not be granted in the case of joint family property passing by survivorship when deaths occur among members of the same generation, as in such instances the share of the deceased coparcener only and not the whole property is to be taxed. This is, in effect, an estate duty, as it falls on the whole share of the deceased coparcener.¹ In the case of non-joint families it will fall on the whole estate. In Great Britain, if property consisting of land or a business passes on death a second time within five years of the first death, allowances are made from 50 per cent where the second death occurs within a year of the death down to 10 per cent where the death occurs more than four years later than the first death. In the United States by a law of 1918 no tax is charged upon a second succession if occurring within five years of the succession upon which estate duty has been paid. The fees chargeable may be graduated. The Commonwealth Estate Duty Assessment Act of Australia fixes, for example, 1 per cent where the total value of the estate after deducting all debts exceeds £1000 and does not exceed £2000, and 1 per cent with an additional percentage of one-fifth of a pound for every £1000 or part of £1000 in excess of the sum of £2000, but so that the percentage shall not exceed 15 per cent. Duty is levied at two-thirds of these rates on so much of the estate as by will, intestacy, gift

¹ The distinction between an estate duty and a succession duty is that the former falls on the deceased's estate as a whole, while the latter falls on the shares of the successors. In the case of a Hindu joint family, an estate duty may be levied on the deceased coparcener's share in the estate as a whole, and a succession duty on the different parts of the deceased coparcener's share devolving on the surviving coparceners.

inter vivos, or settlement passes to the widow or children or grandchildren of the deceased person. Arrangements should, as in the case of the succession duty, be made for the reporting of all liability to estate duty when it occurs.

IX. THE CROWN COLONIES

10. In Ceylon the collection of estate duties has been in force since July 1919.¹ The estate duty includes property of which the deceased was at the time of his death competent to dispose. The Commissioner of Stamps is entrusted with the administration of the Ordinance, but an appeal lies against his decision to the district court. The whole property of the deceased is liable to estate duty, including property in which he had an interest at the time of his death to the extent to which a benefit accrues or arises by the cesser of such interest, property to which the deceased was once absolutely entitled which owing to some disposition of his passes by survivorship to another. Property passing to *bona fide* purchasers for full value, small annuities not exceeding Rs.250, and books and works of art of national interest bequeathed to public bodies are not subject to duty. Property reverting to the settlor under certain circumstances is also exempted. A statutory obligation is laid on the executor to furnish within twelve months of the death of the deceased a full and true statement of the property of the deceased, penalty for non-compliance being double the duty, and a person making a false affidavit is punishable for giving false evidence. For purposes of duty the whole property is valued to arrive at the price which it would fetch in the open market. The rates of duty vary from 1 per cent on amounts exceeding Rs.1500 but not exceeding Rs.7500, 2 per cent on amounts exceeding Rs.7500 but not exceeding Rs.15,000, 3 per cent on amounts exceeding Rs.15,000 but not exceeding Rs.75,000, 4 per cent on amounts exceeding Rs.75,000 but not exceeding Rs.150,000, 5 per cent on amounts exceeding Rs.150,000 but not exceeding Rs.300,000, 6 per cent on amounts exceeding Rs.300,000 but not exceeding Rs.600,000. An estate of the value exceeding Rs.15 lakhs and not exceeding Rs.25 lakhs would pay 10 per cent,

¹ Ordinance No. 8 of 1919, Government Record Office, Colombo. The rules under this Ordinance are published in the Ceylon Government Gazette of 23rd June 1922.

and an estate above Rs.52½ lakhs but not exceeding Rs.60 lakhs pays a duty of 15 per cent, and the maximum of 20 per cent is levied on an estate of Rs.150 lakhs and over. In addition there is a separate settlement estate duty where the property is settled.

In the Straits Settlement under the Stamp Ordinance of 1907 there is a progressive rate which extends to 7 per cent, and in Hong Kong¹ similar legislation has been in force from 1901 and the rate varies from 1 to 8 per cent. In the Bahamas fees are levied on the value of the estate and do not exceed 2 per cent.² In the Barbados a duty is levied by the Estates Duty and Absentees Act, 1895. In Trinidad and Tobago there is the Will and Legacy Duty Ordinance of 1888, where the lineal ancestor pays less per cent than do others, the maximum rate being 6 per cent. In British Guiana there is the Tax Ordinance of 1892. In Jamaica, probate, legacy, and succession duties are payable, and in the Leeward Islands there is the Stamp Act of 1887. In the Falkland Islands,³ Fiji,⁴ and Sierra Leone⁵ there is similar legislation. In the Falkland Islands the maximum rate is 4 per cent under the Probate and Unrepresented Estate Ordinance, 1901. In Fiji succession duties vary from nil to 10 per cent under legislation first imposed in 1882.

X. THE UNITED STATES

11. In the United States there are one or two important points which require emphasis. The first of these is that the Units of the Federation have in recent years adopted a system which might well be the envy of other federations. Half a century ago there were only a dozen states which levied inheritance taxes. To-day, as we have seen, all states, except one, of the Union have the system of inheritance taxation. Four of them have an estate duty in addition to an inheritance tax. New York in 1885 started a new era in inheritance taxation by a law which applied a 5 per cent rate on shares of real and personal property passing to collaterals. In 1891 direct heirs were first taxed.

¹ Stamp Ordinance, 1901, Amending Act, 1902, and Acts of 1909.

² The Amended Fees Act, 1899, 62 Vict. c. 14.

³ Probate and Unrepresented Estate Ordinance, 1901.

⁴ Stamp Ordinance, 1882.

⁵ Stamp Duty Consolidation and Amendment Ordinance, 1905.

The legislation of 1885 became the model for many of the states that enacted inheritance tax laws during the last quarter of the nineteenth century. In 1903 the Wisconsin inheritance tax was the culminating point of this development of inheritance taxation when direct heirs as well as collaterals were grouped in five classes with a separate schedule of rates for each class. The rates were progressive. From this period until 1916, when the Federal estate duty became a permanent part of the tax system, other states modelled their inheritance tax laws according to that of Wisconsin. After the War an additional impetus was given to the enactment and perfecting of state inheritance taxation by a provision in the Federal estate tax, a provision introduced in 1924, by which a rebate was given up to 25 per cent of the federal tax for payments of state death duties. This has, since 1932, been raised to 80 per cent. If a state levied no inheritance taxes the Federal Government collected the entire amount of the tax, and it was to the interest of the states to adjust their inheritance taxation to get the benefit of this credit. The states have thus been encouraged to adjust their rates schedules to be four-fifths of the rate schedule of the federal tax. To-day 35 states have enacted legislation to take full advantage of this Federal state tax provision permitting a deduction of 80 per cent from the Federal tax on account of death duties. Great progress also has been made to avoid double taxation. Thirty-nine states, for example, have reciprocity in regard to the taxing of the intangible personality of non-resident decedents. Thus the taxation of property belonging to a non-resident decedent is waived if the state of the decedent domicile does not tax such property or makes reciprocal provision. The inheritance laws of the state now apply generally to the transfer of all real and tangible personality of estates in the state, quite irrespective of where the owner was domiciled or where he died. Another principle of importance is that the Federal estate duties and the state taxes are on the net value of the estate. In recent years provisions have been made against evasion. The Federal estate duty, for example, includes joint estates by survivorship and gifts made in contemplation of death. Under this duty, too, gifts in contemplation of death are taxed only when they exceed \$5000 and gifts made within two years before a person's death are subject to taxation. The Federal estate tax takes into consideration all property of the decedent, except land located in foreign

countries. If a beneficiary dies within five years a tax paid to the Federal Government on such property is credited against his estate after his death. Estates exceeding \$100,000 alone come under the Federal estate tax, and this appears to be a very high exemption. In addition to the fact that in all cases the state inheritance taxes apply to the net (and not to gross) estates of resident decedents, there are the following general characteristics : Most states include all classes of property, as for example, where joint estates exist the transfer of a decedent's interest is taxed. The Federal Government and a few states tax a surviving husband or a wife on one-half of the property. Gifts are taxed in all states, except four. All states except two allow personal exemptions to the individual beneficiaries or to the state as a whole, the exemptions being graduated according to the relationship of the beneficiary with the decedent. Exemptions are given to widows to a greater degree than to other beneficiaries. Exemptions, too, are allowed as a rule to non-resident decedents. The usual method of inheritance tax law in the states is the taxation of inheritances, the rate for collateral heirs being higher than for direct heirs. In recent years, however, an estate tax is becoming somewhat more popular owing to the influence of the Federal estate tax.¹

XI. FRANCE AND OTHER COUNTRIES

12. Inheritance taxation in France is of greater importance than in any other country of Europe, Great Britain alone excepted, and is in marked contrast to that of Germany and Italy in its productivity. Various reforms have been made in the present century. In the first place there has been a considerable steepening of rates, especially on distant heirs, and on the size of the inheritance. There has also been discrimination since 1917 against small families. Secondly, the administration of the tax is of interest as careful steps have been taken against evasion. Officials check the returns with income and other tax returns. Experts in the case of business stocks and goodwill are available for valuation. Banks and insurance companies cannot make over

¹ For a convenient summary of the United States inheritance taxes see *Tax Systems of the World*, prepared under the direction of the New York State Tax Commission, 1934, Chicago, The Corporation Trust Company, 205 W. Monroe Street. See also *The Taxation of Inheritance*, by Shultz, 1926, Boston (Houghton Mifflin Company).

property to beneficiaries without the tax receipts for succession duties. When a joint bank account was opened the depositors have to declare within three months the names of the depositors and for inheritance taxation the shares of each in the account. Arrangements are made with neighbouring States, notably with England and Belgium, to furnish details of the property of deceaseds in the other country. The penalties for evasion and fraud include heavy fines, five years' imprisonment, and loss of civic rights. In 1901 four important changes were made, viz. (1) the duties were levied on net (and no longer on gross) capital value ; (2) the rates were progressive not on the total estate value, but on the increments or slices of inheritance. This is sometimes called "progression by bracket" ; (3) where the property devolved upon a person for a life tenancy only and remainder interests the tax was determined in accordance with the expectation of life of the beneficiary or life tenant ; and (4) administration provision was made to prevent fraud and evasion. At the present time the tax on succession is composed of (1) the estate duty, which varies from 1·2 to 46·8 per cent on the total net estate if it is not shared by at least two children ; (2) the transfer taxes or succession duties collected again on the share of each heir. The two taxes taken together may not absorb a total of more than 40 per cent of the inheritance.

In regard to the German inheritance tax the Dawes Committee in their Report 1924 pointed out the very inadequate rates of duty and suggested that there was "considerable room for increased taxation under this head".¹ After the War there were efforts made on the part of Socialists and others to increase the rates of this form of taxation, and also to levy an estate duty on the British model. Recently, however, the pendulum has swung the other way and the Imperial tax in Germany has become of practically no importance as a source of revenue. The tax is graduated from 2 to 60 per cent and is retained in its entirety by the National Government. In Italy the successions tax is valued on the net value. This total is increased by 2 per cent, the presumptive value for jewellery and currency and by 5 per cent for furniture and fixtures. There are five classes of beneficiaries, the rate varying according to the amount of the estate and kinship with the decedent. The rate of tax may be as high as 50 per

¹ Report of the First Committee of Experts, 1924 (Cmd. 2105), pp. 60-61.

cent in the case of collaterals. The reasons for the unimportance of inheritance taxes in Italy may be due to the view of the Fascist government in regard to the taxation of the family, viz. it should be very low or given up entirely because the family must be preserved at all costs as it is the foundation of national unity. Another reason is sometimes said to be that Italian taxation already falls unequally in some parts of the country, especially in Northern Italy, but this might be equally well said of the New England States of the American Union.

In Switzerland, as, for example, in the cantons of Berne and Zurich, where there are succession duties, the rates vary according to the property received by inheritance or gift from residents of the canton concerned. In the former the rate varies from 1 to 30 per cent according to kinship, while in the latter parents, husbands, wife, descendants, pay no tax, while others pay from 3 to 22.5 per cent. In Holland there are five classes of heirs and the rate varies from 2.5 per cent to 37 per cent. In Spain there are nine classes, the rate varying from 1.2 to 36.9 per cent. In Japan, under the law of 1905 as amended by the law of 1926, descendants pay from 5 to 16 per cent according to the size of the benefaction, and others from 10 to 21 per cent.

CHAPTER XXIV

OTHER DIRECT TAXES

THE surface of the subject of direct taxation has now been scratched, but there remain for discussion other direct taxes of varying importance. It is proposed to deal with (1) poll or capitation taxes ; (2) direct consumption taxes, such as those on inhabited houses, huts, carriages, men-servants, and what is now important, motor cars or automobiles ; (3) some special aspects of the taxation of surplus. In recent years governments have devoted considerable attention to the taxation of surplus in the form of unearned increment duties, excess profits duties, and of the taxation of corporations. The War period threw a new light on this last aspect of tax revenue. The Excess Profits Tax in the United States yielded in 1918 the largest annual amount ever produced in any country by a single tax, 2505 million dollars or £511 millions sterling. The British tax in five years from 1916–17 to 1920–21 brought into the Exchequer nearly £1156 millions sterling. In the post-War period corporation taxes have increased in popularity and have in many countries been very productive.

POLL OR CAPITATION TAXES

1. Poll, head, or capitation taxes are of very ancient origin, and although nowhere a major source of revenue, except in Siam and the Philippines, are more common than is generally supposed. They are to be found in the United States, Canada, Sweden, Switzerland, some Balkan countries, the Union of South Africa, East Africa, the Fiji Islands, Madagascar, French Somaliland, Turkey, Persia, Ceylon, Burma, and in India. In the United States poll taxes are only about 0·2 per cent of the total revenue

of the States of the Union, and in Sweden 0·1 per cent of the total revenue. In Siam, on the other hand, poll taxes are equivalent to one-half of the direct tax revenue. In the Philippines they yielded greater revenue than all other sources combined. These have at various times been levied upon the conquered as, for example, in ancient Greece, where the tax was regarded as a badge of slavery. The Romans levied the tax on colonials and Islamic rulers on unbelievers. At the present time the existence of these taxes may be explained by the lack of tax consciousness where there is little regard for justice in the distribution of the burdens of governmental expenditures, and to undeveloped economic conditions. The tax, too, is sometimes used for non-fiscal purposes as in the Southern States of the American Union except North Carolina. In these states where the payment of the tax is a necessary condition of suffrage, it may be used to restrict the negro vote or to prevent it altogether.

In some of the states of the Union it is used as a complement to the income tax and assists in checking evasion of the personal income tax. In its true form the poll tax makes no allowance for the income or other taxes paid by the taxpayer or for his family circumstances. Governments have sometimes, however, graduated the tax, as in England in 1379 when the tax was graduated according to rank, in France in 1701 when the taxpayers were divided into 22 classes, and in Russia during the time of Peter the Great in 1718 when the taxpayers were divided into three groups. The graduation of this tax makes it a type of income tax rather than a poll tax. Occasionally the family takes the place of the individual as the unit of assessment and exemption is ordinarily based on sex, or age, or on both, although social position has sometimes been the basis of exemption. The tax is not easy to collect, and in many States of the American Union only those who pay other taxes pay the tax, which varies from 1 to 5 dollars a year per head. It is by no means easy and convenient to collect. It is sometimes provided that the tax may be recovered from debtors of the person assessed, or from employers. The burden of the tax, except on rare occasions, rests on the person taxed. If the tax were so large as to lead to an increase in wages then it would be shifted to the employer. This is rarely the case. Sometimes when levied as a prerequisite of suffrage it may be shifted to political parties who supply the funds to bear the tax.

The first poll tax of which there are details in English history is the tallage of groats, 1377. This tax is said to have been modelled on the French tax. The tax of 1377 was "four pence, to be taken from the goods of each person in the kingdom, men and women, over the age of fourteen years, except only real beggars". The tax of 1379 was graduated, as noted, and included "every merchant stranger". The two Dukes of Lancaster and Bretagne were assessed at 10 marks each (£6 : 13 : 4), Earls at 6 marks (£4), and the list included barons, baronets, esquires, members of the legal profession, the business community, farmers, down to "every married man (not of the estates foresaid) for himself and his wife, and every man and woman sole over the age of sixteen years, except real beggars 4d." The clergy and the unmarried were also assessed. "Commissioners, appointed to assess and collect the tax in the various counties and towns, were sworn to faithful performance of their duty; but so difficult did the collection prove to be, that it was necessary to get in the arrears by farming the tax. The farmers acted with rapacity and insolence. Endless disputes occurred regarding the limit of age."¹ The Wat Tyler rebellion, it is said, arose from this impost on account of a dispute over the age of a girl whose exemption was claimed as being under fifteen years. Poll taxes were also levied on aliens, and a tax of this description was granted to Henry VI. for life. In the poll tax levied in 1513 in Henry VIII.'s time wages were taken as one of the measures of taxable capacity.² Under Charles I. a poll tax was voted in 1641 for payment of the Northern Army, and levied upon persons "according to their ranks, dignities, offices, callings, estates, and qualities". It varied from £100 on a duke to 1s. on those with an income of £5 per annum and 6d. on persons below this amount. Poll taxes were levied in 1660, 1666, 1677, and especially in William and Mary's reign up to the year 1698, when they were finally discontinued. Samuel Pepys wrote in his Diary, when the collectors in December 1660 demanded 10s. for himself and 2s. for his servant, that he paid the amount "without dispute", and he naïvely adds, "I put by £10 for them, but I think I am not bound to discover myself". No wonder Bacon speaks of the English as "the least bitten in purse of any nation in Europe".

¹ Dowell, *History of Taxation and Taxes in England*, vol. i. p. 113.

² Every man who had 40s. in wages—12 pence.

In the United States the poll tax is levied by the constitutions of 13 states of the Union, and in 9 of these the levy of this tax is also permitted to local authorities. The constitutions of 30 other states permit the imposition of the tax by State or local governments. The Federal Government also levies a poll or head tax of 8 dollars on every immigrant entering the United States. The proceeds of the tax collected within the states of the Union are usually devoted to roads, streets, and schools.¹ A provincial poll tax has been levied by British Columbia since 1917. According to the Act males above 21 pay 5 dollars annually.² Soldiers, sailors, and persons paying income tax, land tax, licence fee or a tax on personal property exceeding 5 dollars are exempted. In 1925 the total yield was only 172,000 dollars, or 2·3 per cent of the total tax receipts of that province of Canada.

In the Union of South Africa a poll tax was levied in the Transvaal and the Orange Free State and a hut tax in the Cape Province, Natal, and the Transkeian territories before 1925. In the Transvaal each adult male native was required to pay a poll tax of £2 per annum, with an additional £2 per annum for each wife in case he had more than one. In Natal a tax of 14 shillings was levied per hut occupied by natives. A hut tax in the Cape was charged at the rate of 10 shillings per hut. Legislation regarding these hut or poll taxes was consolidated by the Natives Taxation and Development Act of 1925. Under this Act a general tax of £1 is levied upon every native male adult domiciled in the Union or residing for a continuous period of twelve months prior to the date on which the tax falls due. In addition, there is also a local tax of 10 shillings for every hut or dwelling situated in a native location. This tax, which must not exceed £2 annually, is paid by the occupier. Exemptions are granted in certain cases, as, for example, those natives who are in necessitous circumstances or who are prevented from working owing to their age or some other cause, and those paying an income tax of not less than £1 in the previous year. The local tax of 10 shillings in respect of every hut is allotted to Native Councils or Boards, while that

¹ Cf. *Tax Systems of the World* (1935, Chicago, Commerce Clearing House Corporation Trust Company, 205 W. Monroe Street).

² Exemptions include persons over 60 years of age with an income not exceeding \$700 per annum and those paying provincial or municipal taxes amounting to \$5.

portion of the tax collected from areas outside the jurisdiction of these Councils or Boards, together with 20 per cent of the general tax, is paid into a special account called the Native Development Account. The proceeds are used for education and other welfare measures designed for the uplift of the natives. Persons other than natives are taxed through a combined poll and income tax, a modified form of poll or capitation tax. In the Transvaal all bachelors, other than natives, under 25 years of age and not paying Union income tax, are taxed at a rate of £1 : 10s. annually. Married persons are charged at the same rate, but in addition they have to pay 15 per cent of the income tax paid to the Union Government in the preceding year in respect of income derived from sources within the Transvaal. Unmarried persons of more than 25 years are charged at $1\frac{1}{2}$ times this rate. The revenue from this source until recent years was the largest of Transvaal revenues. The tax is levied on similar lines but at different rates in Natal and the Orange Free State. There is no such tax in the Cape Province.

Women who do not pay Union income tax, and students having no income of their own and attending recognised educational institutions for three months immediately before the date when the tax becomes due, are exempted from the poll tax. If the tax is not paid within a specified date a penalty of 10 per cent is levied for each month or part of a month in default. Employers are entitled to deduct the tax from the wages of their employees if the tax is recovered from the former. The taxes cannot be considered productive.¹

In Burma taxes are levied in lieu of the revenue assessable on land, and it is confined to certain areas of shifting cultivation in certain hill tracts and frontier areas. The *taungya*, for example, is levied on each male who has completed 18 years of age or on each family of persons cultivating the land, the rate being fixed from time to time by the Government subject to a maximum of 2 rupees per annum.² The *thatthameda* collected in Upper Burma is a tax in the main on non-agricultural incomes and is an apportioned tax. There is also in Lower Burma a capitation tax which is not apportioned. It is a fixed payment in money and collected

¹ Native taxes in 1933–34 were £910,000 only out of a total from national taxation of £29,965,000.

² Section 33 of the Burma Land and Revenue Act of 1876.

from males between the ages of 18 and 60 years.¹ In Assam an annual tax on any person above the age of 18 years cultivating land during the year of assessment, or on each family or house of persons, is levied in place of the land tax or revenue. The taxes are as a rule levied on the household at the rate of 2 or 3 rupees per family, and are levied on tribes in undeveloped tracts where it is not possible to collect land revenue on any systematic basis. In British Baluchistan a similar tax is levied on graziers who move about from place to place, which is analogous to the poll taxes of Burma and is graduated according to the size of the flock-owners. These taxes in India as in Burma date from pre-British times and are suitable to the primitive conditions obtaining in these parts.

The main objections to capitation taxes are that they are inconvenient and do not take into account the real ability of the taxpayer to pay, being usually regressive, and also that they are unproductive and often expensive to collect, as evasion is not difficult. The principal argument in favour of these taxes is their universality, each citizen contributing to the cost of government whose existence is brought home to him through the tax. In Adam Smith's view "capitation taxes are levied at little expense, and, where they are rigorously exacted, afford a very sure revenue to the State. It is upon this account that in countries where the ease, comfort, and security of the inferior ranks of people are little attended to, capitation taxes are very common. It is, in general, however, but a small part of the public revenue, which, in a great empire, has ever been drawn from such taxes; and the greatest sum which they have ever afforded, might always have been found in some other way much more convenient to the people."² Its use as a complement to the income tax in the form of a flat-rate tax is of some importance as it may check personal income-tax evasion. It is for this reason that tax administrators sometimes favour its retention.

¹ Section 34 of the Burma Land and Revenue Act of 1876. Because it is levied as a flat rate and has never lost the stigma attached to its having originally been a tax imposed by the Burmese kings on the conquered, it is unpopular. The rate is Rs.5 for married men and half that rate for single men.

² *The Wealth of Nations*, Bk. V. ch. ii. pt. ii. art. iv. Montesquieu (*L'Esprit des lois*, Bk. XIII. ch. xiv.) thinks that these taxes are looked on as badges of slavery, because they are fixed at so much per head. Adam Smith (Bk. V. ch. ii. pt. ii. art. ii., Cannan edit. vol. ii. p. 354) remarks that "every tax, however, is to the person who pays it a badge, not of slavery, but of liberty".

DIRECT CONSUMPTION TAXES

2. Direct consumption taxes are strikingly insignificant in modern tax systems. An exception, however, must be made in the case of automobiles or motor cars, the taxation of which has been in Great Britain and France unusually productive. Indirect consumption taxes have taken the place of these direct taxes. In these days of industrial progress it is, for example, more easy, and certainly more productive, to collect revenue from taxes imposed at a particular stage of manufacture than from a scattered body of consumers. Moreover, direct consumption taxes are usually on luxuries or non-necessaries. Taxes, then, on these are inelastic and unproductive, especially when compared with excise duties.

In Great Britain the direct consumption taxes are licences¹ on carriages and motor cars, armorial bearings, male servants, together with the game, gun, and dog licences. The inhabited house duty, abolished from 1924–25, was found to be a convenient mode of assessment on account of the universal use of houses. The house rent paid is usually a good criterion of one's income, and accordingly of one's taxable capacity. Probably on account of the difficulty of obtaining actual rents, recourse was had to the taxing of hearths and windows. The former tax was abolished after the Revolution on account of its inquisitorial nature, and a tax of two shillings on every inhabited house, with additional taxes if there were ten windows or more, was imposed. A tax on the basis of windows is to be condemned as a tax on ventilation. This was afterwards modified to a window tax from 2d. to 2s. per window.² The objection to this type of tax is that it falls more heavily on the poor than on the rich. Until April 1924 the inhabited house duty was a permanent direct tax upon occupiers of dwelling-houses based on the annual letting value. In the administrative county of London the annual value depended on the quinquennial valuation under the Valuation

¹ Consumption licences are to be distinguished from trade licences, e.g. those granted in Great Britain to distillers, brewers, auctioneers, house agents, pawn-brokers, and dealers in plate.

² "The window tax, as it stands at present (January 1775), over and above the duty of three shillings upon every house in England, and of one shilling upon every house in Scotland, lays a duty upon every window, which, in England, augments gradually from twopence, the lowest rate, upon houses with not more than seven windows, to two shillings, the highest rate, upon houses with twenty-five windows and upwards" (*The Wealth of Nations*, Bk. V. ch. ii. pt. ii. art. i., Cannan edit. vol. ii. p. 330).

Metropolis Act, 1869. The last new assessment was made in 1921, and for the rest of Great Britain a new assessment came into force for 1923–24, the previous assessment having taken place in 1910. The rate of duty¹ for private dwelling-houses, *i.e.* except for farm-houses, hotels, public-houses, coffee-shops, residential shops, or lodging-houses, was 3d. in the £ if the annual value is £20 or more and does not exceed £40, exceeding £40 and not exceeding £60, 6d., and exceeding £60, 9d. For farm-houses, hotels, public-houses, coffee-shops, residential shops, or lodging-houses the rates within these limits were respectively 2d., 4d., and 6d. A house let in tenements or flats² and inhabited by two or more persons or families was usually subject to one assessment only, except in certain cases, *i.e.* a house providing separate dwellings may be the subject of a separate assessment for each dwelling of an annual value not exceeding £60. The taxation of houses is hardly a suitable source of revenue for a State or Federal Government, which should tax only incomes from houses, leaving the taxation of houses to local bodies. The house duty yielded in 1923–24, *i.e.* the last year for which it was in force, only £1,900,000 out of a total tax revenue of £718,000,000. The tax was abolished in 1924, and the British Chancellor of the Exchequer remarked that it was to large sections of the working professional classes of very moderate means an unnecessary and irritating addition to more necessary and appreciable burdens. He also said that the remission would be a greater relief to the married man with an income of £500 a year than a reduction of 6d. in the income tax.

The present duties on carriages, men-servants, and armorial bearings belong with the house duty to a class of taxes hitherto known as the assessed taxes. Before 1785 the taxes on carriages and male servants were under the commissioners of excise, while the then new taxes on saddle, carriage, and racehorses were under the commissioners of stamps and were termed “unstamped duties of stamps”. The window tax and inhabited house tax were under the commissioners for the affairs of taxes. In 1785, to prevent fraud and evasion and to secure more efficient administration, Pitt placed all these taxes which fell on the luxurious expenditure of the rich under one authority, the board of taxes,³ and these taxes, viz. those on houses, carriages, men-servants, saddle and carriage horses, and racehorses, came to be known as

¹ 1921–22.

² 3 Edw. VII. c. 46, § 11.

³ 25 Geo. III. c. 47.

the assessed taxes. Hair powder and armorial bearings were subsequently added. Those on horses and hair powder have been remitted. Dog and sporting licences, although not assessed taxes proper, are analogous. The tax on motor vehicles is now a very productive tax. The yield in 1934 was nearly £30 millions. The present system of motor taxation was recommended by a representative Departmental Committee as being the fairest and best. There have been few complaints other than those raised against any form of taxation. Special rates are fixed for taxis, tractors, and for cars used solely for the conveyance of goods in the course of trade. Fire-engines and ambulances or road-rollers kept by a local authority are exempted from taxation. Other motor vehicles not exceeding 6 h.p. or electrically propelled pay £4 : 10s., and exceeding 6 h.p. for each unit or part of a unit of h.p., 15 shillings.

Although the French tax on doctors and windows was annulled for State purposes by the law of 31st July 1917, when the scheduled income taxes took its place, there are still direct consumption taxes such as the tax on furnished houses, on horses, wagons, donkeys, mules, gamekeepers, apprentices, dogs, bicycles, and automobiles. In some cases the proceeds go to the State as in the case of the taxes on gamekeepers ; those on apprentices and bicycles go to the State while others go to the communes, such as the dog tax ; others such as those on horses, donkeys, and automobiles are shared. The tax on automobiles, which is graduated according to weight and surface area, is shared with the departments. Nine-tenths go to the Treasury and one-tenth to a common fund which is divided each year between the departments. Direct consumption taxes are generally much more suited for local taxation than for State taxation, and there is a tendency for direct consumption taxation to fall into disuse in State or Federal taxation systems.

THE TAXATION OF SURPLUS

3. We have already seen that taxes are paid from incomes, and in this connexion these incomes may be said to be made up of (1) payments required to maintain the supply of the agents of production, *i.e.* necessary costs, such as the subsistence wage, the minimum rate of interest and the minimum rate of profits, and (2) surplus, such as pure rent, quasi-rent, pure profit, or monopoly

or chance gains. The taxation of surplus, therefore, covers a wide field. Considerable attention has been given to this part of the theory during and subsequent to the War, largely owing to the fact that governments and their expert officers were compelled to give far greater attention to the subject owing to the necessity in this period for increased revenues. It is proposed here to confine the discussion to that portion of the taxation of surplus which Pigou¹ has well described as windfalls, taxes assessed upon objects which have increased in value without effort, foresight, or capital on the part of the owner or owners. In normal times windfall taxation takes the form of taxes or duties upon the increments of land value. John Stuart Mill² was the first to use the term "unearned increment", although the idea is to be found in Ricardo's *Principles*.³ In exceptional circumstances this form of taxation is extended in other directions as, for example, in the taxation of war profits and excess profits. The unearned increment of the taxation of land has already been discussed.⁴ We have seen that John Jacob Astor in New York, and the Duke of Westminster in London, were enormously enriched by the possession of urban sites without any presumable effort on their part as owners of the property. In such cases the State is able without any disastrous effects on production to tax part of the surplus wealth in the reward of any effort of the owner. In this chapter we shall confine ourselves to the taxation of corporations which is sometimes called the corporate excise or the franchise, and to the taxation of abnormal returns in the form of war and excess profits. Most of the belligerent countries, it will be remembered, taxed war profits and excess profits in war-time with great benefit to their national Exchequers.

THE TAXATION OF CORPORATIONS

4. In regard to the taxation of corporations it is necessary to remember that this form of taxation has greatly developed in recent years. At the present time there are nearly 50 countries which tax either the income or the profits of corporations, and in nearly every case all classes of corporations are liable for the tax.

¹ Pigou, *A Study of Public Finance*, ch. xvi. p. 177 (Macmillan, 1928).

² Book V. ch. xi. § v.

³ Ch. x.

⁴ *Vide Chapter XVIII.*

The following table summarises briefly the taxation of corporations at the present time in some countries of chief industrial importance :

TAXATION OF CORPORATIONS IN VARIOUS COUNTRIES

Country.	Date of Original Law.	Basis of Tax.	Rate of Tax (on 1st Jan 1935)	Surtax
Great Britain	1918	Net income	22½%	..
Canada	1917	Net income	12½*	..
Australia	1922	Net profits	5	..
New Zealand	1923	Net profits	3 to 22½	30
South Africa	1925	Net profits	12½	..
British India	1922	Net profits	13·54	6·25 + surcharge temporarily 25
Sweden	1920	Profits and property	3 to 15	..
United States	1916	Net income	12½ to 15	..
France	1926	Net profits	12	..
Germany	1925	Net income	20	..
Italy	1924	Net profits	14	..
Japan	1920	(a) Net profits under income tax (b) Business profits tax	5 resident, 10 non-resident	..
Austria	1924	Net profits (previous year)	25	11·4 of tax
Belgium	1919	Undistributed profits	Grad. to 9 90 domestic; 11 foreign	10 of tax
Czechoslovakia	1927	Net profits	9	Grad. 2-6
Netherlands	1917	Distributed profits	9·05	..
Argentina	1932	Net profits earned in Argentina	5 ‡	0·36-7
Chile	1925	Net income	Grad. 6-10, § for mines 7-12	..

* Subsequently raised to 15 and from 1936 to 17 per cent.

† Iron and steel mining, manufacture of agricultural products, and business on the produce or stock exchanges are exempt.

‡ If shareholders pay the tax on dividends these rates are reduced by one-half of surtax; 0·36 to 7 per cent in the case of Argentina.

§ Foreign companies are subject to additional 6 per cent on net income earned in Chile: additional 6 per cent when distributed to foreigners. Cf. *Tax Systems of the World* (Chicago, 1935).

These countries refer to central taxation only and do not include corporation taxation in the units such as the states and provinces of the United States and Canada respectively. In the United States, for example, as we have seen, the taxation of corporations is to be found in all states. The procedure of taxing these corporations followed differs remarkably from state to state, and although the diversity is not as great as it once was, it is still very marked. In Great Britain the taxation of business has not been popular to the extent that it has been in France and the United States. The taxation of companies in the British Income Tax (Schedule D) is based on the theory that as the tax is collected at the source companies pay the tax and the taxpayer may recover any excess payment of the standard rate over the rate applicable to his income later from the Revenue.¹ In many countries, however, corporations, *qua* corporations, are taxed. In the United States more than one-half of the receipts from the income tax in recent years have been derived from corporation profits, and these corporations are taxed at the rate of 12½ to 15 per cent. Dividends on corporations in this way are exempted from taxation under the personal income tax. It is assumed that the American income tax is a graduated tax on personal incomes. The wealthy classes of the community, therefore, who own stocks or shares are probably less heavily taxed than they otherwise would have been. They would have had to pay a much higher percentage than 15 owing to the size of their incomes. Ability, therefore, in this respect is neglected. In the view of many it is preferable to make the corporation merely a conduit pipe through which personal income passes, and not to tax it as a corporation except in regard to undistributed profits. But countries have already obtained much revenue from corporations, so that it is unlikely that such a prolific source of revenue would ever be given up in spite of the fact that a Committee of the National Tax Association in the United States have pointed out that the corporation income tax is an outstanding example of the throwing aside of the theory of ability. Apart from the taxation of profits, a tax on capital stock is levied by the Federal Government under

¹ Cf. Cl. 24 of the Draft Bill of the Income Tax Codification Committee, Cmd. 5132, 1936, p. 18: "The amount of the profits of a business for any accounting period shall be computed in accordance with the ordinary commercial principles applicable to the computation of profits of that business". Cf. Cmd. 5131, p. 141.

the National Industrial Recovery Act at the rate of one dollar for each thousand dollars of adjusted capital stock. It is for the privilege of doing business. It dates really from the Revenue Act of 1916. It is imposed on corporations but not on individuals and partnerships and is accordingly discriminatory. The assessment is made on the valuation of the capital stock, and this includes stock, undivided profits, tangible property, and good-will. The valuation of this capital stock is conceived by some writers on American finance to be an impossible task and to be justified only as a War Revenue measure.¹ In France companies are taxed at the rate of 12 per cent on their net profits, with a special rate for profits not exceeding 10,000 frs. In Germany there is the tax on corporation income (*Körperschaft*), the rate of tax being 20 per cent. Certain companies with a capital not exceeding 50,000 reichsmarks pay on a basis of a graduated scale from 10 per cent to 30 per cent, but in no case does the tax exceed 20 per cent of the taxable receipts of companies.

In many ways the taxation of corporations may be looked on as taxation of business, but it is preferable to regard it as a tax on corporation surplus. Many of these corporations, especially those of a monopolistic nature, show profits greater than are required to attract capital and to maintain production. Governments confer certain special privileges or a franchise on a corporation, and by this the corporation possesses certain advantages or privileges.² When as a result the earnings of the corporation are in excess of a reasonable return on the amount invested in the real estate, machinery, or other property, and when this excess is not attributable to any other cause except its corporate charter, it is only just that corporations should be taxed for the additional privileges they enjoy over individuals. All things considered, it has been considered advisable to classify the taxation of corporations under the taxation of surplus, although much may be said against this procedure. It is one largely of convenience. Henry C. Adams believes "the corporation tax and the monopoly problem are closely allied, and no satisfactory adjustment of corporate taxation can be expected except it be made under the influence

¹ Cf. Lutz, *Public Finance*, p. 406 (D. Appleton & Co., New York, 1928).

² For the taxation of corporations, see Seligman, *Essays in Taxation*, chs. vi.-viii., 9th edition, Macmillan, 1921.

of some general theory respecting the solution of the monopoly problem".¹ These corporations possess certain rights, such as the right to be a corporation, and thereby to use the corporation name, to sue and be sued as a corporation, and also the right to do or to act. Limited liability and juristic personality are some of the privileges which corporations enjoy. There is a third group of special privileges, which includes good-will and the right to use public streets for transit by tramway and other companies, etc. The tax may be levied on the net receipts, which constitute the best index of tax-paying ability. In America railways and other transportation companies are taxed by a special board. If the railways spread through, as they do, several states, relative mileage is usually taken as the basis of apportionment of the receipts. Banks, insurance companies, and land associations are also assessed, as are mining and other monopoly companies, together with public utility corporations, such as electric lighting and gas. For State purposes a tax on earnings or on capital or loans received within the state may be taken as a guide, except for railways, for which relative mileage is a better test. No distinction should be made between domestic and foreign corporations so far as units of a federation are concerned. If the corporation is taxed on property, the property outside the state should be exempted. The main point which we are here concerned with is the question of obtaining a share of the surplus which results from the existence of the corporation. Opinion is not unanimous as to whether the corporation tax should be administratively Commonwealth or Federal in the United States. Some authorities, such as Adams, hold it should be exclusively a source of State revenue, while others, like Seligman, think it should be Federal rather than local. He therefore proposes Federal administration with State apportionment of the tax. The Committee appointed by the National Tax Association to prepare a plan of a model system of State and local taxation in the American Union, in suggesting a tax upon business in addition to income and property taxes, recommended that the taxation of business should be in the hands of the State Commission or of the State Tax Commissioner in order to produce a simple and uniform system in place of the vexatious and unequal methods now employed in many of the states of the Union. Federal adminis-

¹ *The Science of Finance*, p. 453 (New York: Henry Holt & Co.).

tration of the tax makes for uniformity of rates and prevents discrimination. On the other hand, historical reasons often predominate in the control of a tax, and units which have for long taxed corporations would be unwilling to hand it over to the Federation which would apportion the proceeds of the tax.

In Great Britain there was a corporation tax from 1920, when the Finance Act of that year charged (1) all British companies carrying on any trade or business, and (2) foreign companies carrying on any trade or business in the United Kingdom so far as those profits arose in the United Kingdom. The tax was 5 per cent of the profits. Limited liability companies alone were liable to this tax, but many public utility companies and building societies were exempted. Public utility companies, like gas, water, electricity, tramway, hydraulic power, dock, canal, or railway undertakings, whose prices for services rendered or dividends distributed are limited by an Act of Parliament, were excluded from the scope of the Act. The chargeable profits included income from immovable property and investments, but excluded interest on loans and royalties paid to persons other than those having a controlling interest in the company. Interest on certain Government securities, profits of industrial and provident societies arising from trade with their own members, and societies for house-purchase for members were excluded from liability to the tax by the Finance Act of 1921. Interest on mortgages was allowed for while computing the profits of companies half or more of whose gross income was derived from rents or profits of lands and tenements in the United Kingdom. The first £500 of the profits of companies was free from tax. Excess Profits Duty was deducted while computing profits for purposes of the Corporation Profits Duty. The net receipts amounted in the first year (1920-21) to £650,000, and £23,451,273 in 1923-24. The corporation profits tax has been abolished since 1st July 1924 in order to further the development of trade. Assessments, however, continue to be made in respect of profits arising prior to 30th June 1924. The corporation profits tax should not be confused with the corporation duty imposed by the Customs and Inland Revenue Act of 1885 as a stamp duty by way of compensation to the revenue for the non-liability to death duties of certain property vested in bodies corporate or incorporate. The corporation duty was levied at the rate of 5 per cent on the net

annual value, income, or profits accrued in respect of real or personal property vested in such bodies.¹ The development of the taxation of corporations in the United States is of interest. Previous to the introduction of the general corporation tax, attempts were made to reach corporation incomes by the property tax with the assessment of real and personal property by local officials. When the defects of this system were recognised a special board was appointed to assess transportation companies, especially railways, and the basis of taxation was changed in many cases from property to volume of business, value of stocks and bonds, and other elements supposed to indicate taxable capacity in the case of banks, insurance companies, and public service corporations. Railroads were taxed on many bases. A common method followed is the *ad valorem* method, the taxation based on the value of the property of the railroad. Another method is the taxation based on gross receipts, or both methods are used in combination. In regard to the first method it is usual to determine the value of the property as a whole in place of attempting to determine the value of only that portion which happens to be within the state, and after the valuation of the property is arrived at, a distribution of the total is preferably done on a mileage basis. In the valuation of railroads elaborate information is required relating to mileage cost, net earnings, and similar matters. This is supplemented sometimes by expert inquiries on the part of the State Tax Commission as in the case of Wisconsin, and by a capitalisation of earnings, or of estimating the aggregate market value of the capital on the basis of market quotations. The taxation of railroads on the basis of earnings is usually made in the United States on gross earnings rather than on net earnings. It is argued in favour of this method that the State governments have to meet necessary expenditures, and these cannot depend on whether a business makes profits or not at the end of the year ; that earnings are a better test of ability to pay and the taxation of gross earnings cannot be on the whole unsatisfactory in view of the large differences between gross and net earnings among the various railroads. Net earnings, however, would be more in harmony with the principle of ability to pay. The taxation of gross earnings has the advantage of simplicity even if it does not equalise taxation burdens. The taxation of gross earnings raises

¹ Acts 48 & 49 Vict. c. 51.

the problem of the rate of tax and the method of apportionment of earnings to each state. In the case of taxation according to earnings, one has to hold the scales even in regard to railroads as compared with other corporations taxed by the State on the basis of property. This can be done by calculating the equivalent *ad valorem* burden represented by a certain rate of gross earnings and adjusting the non-earning rate to obtain fairness. Mileage within and without is a good way of fixing the apportionment of earnings to the State. In one Federation, that of India, the large railways are centrally administered and the proceeds go to the Federal Government and they are not taxed by provincial governments. The Committee appointed by the National Tax Association to prepare a plan of a model system of State and local taxation in the American Union suggested a tax upon business in addition to income and property taxes. They considered (1) the imposition of a tax of fixed amount annually, (2) a tax upon net income, and (3) the feasibility of adopting various external indices, such as gross receipts, rentals, and the like, which could be considered to be approximately a fair guide of the profits of a business. The Committee, after dealing with each of these three methods, concluded that except in certain cases a business tax should be levied upon the net income derived from businesses carried on within the state levying the tax. Every business of any size makes a return of its net income to the Federal Government, and therefore it is convenient as well as practicable to impose a business tax upon net income. Thus in the case of entering State concerns the determination of the proportion of the income derived in each state, but the Committee believed this was not a serious difficulty and was far superior to any tax levied according to external indices of business profits. The Committee also suggested that the return of the business tax should be proportional and not progressive and that it should be moderate. One per cent of the net income derived from business done in the locality was considered to be a very light tax, and in general a tax of 2 per cent was thought to be adequate. In no case should for State purposes the rate exceed in the opinion of the Committee 5 per cent.

EXCESS PROFITS TAXATION

5. Another class of taxation of surplus is excess profits taxation or windfall taxation, which is charged on profits of trading con-

cerns and not on individuals. The tax was a method of obtaining from highly developed industries a share of the return assumed to be normal. This taxation may be either a war profits tax or an excess profits tax, that is, an excess above a certain figure. In the late War very great demands were made on certain businesses, especially those engaged in the manufacture of munitions, and profits were made by firms which were able to take advantage of these exceptional circumstances. Such profits were far above the pre-War level and far higher than what were required to maintain output. The amount of tax was determined not by the total profits but by the profits in excess of a certain standard. In short, the taxation of this was a tax on profits in excess of a prescribed return on capital.

In 1863, during the American Civil War, the state of Georgia levied a tax from 5 to 25 per cent on profits in excess of 8 per cent on capital stock. In the early part of 1915, when Germany was importing food supplies from Scandinavia, the tax was introduced there, and shortly afterwards in Great Britain, first as a munitions levy and subsequently as an excess profits duty. In the United States the excess profits tax dates from 1916, when a tax of $12\frac{1}{2}$ per cent on the profits of munition manufacturers was introduced. This subsequently developed into a war profits tax on corporations reaching a maximum of 80 per cent and an excess profits tax which reached a maximum of 65 per cent, but these taxes were discontinued from 1st January 1922. Seldom has the fashion of imitation been so evident in taxation, for in less than two years, *i.e.* in 1917, more than a dozen countries adopted this system of taxation. The two main problems which confronted all countries were (1) the determination of normal rates of profits beyond which the surplus was liable to a special tax ; and (2) the method of taxing this excess. The excess profits duty proper, as in Great Britain, was purely a temporary measure and was discontinued in 1921. If the tax is purely a temporary measure, it is possible to take the profits of a particular period as the standard. If, on the other hand, the tax is to continue for a period as part of the general tax system, it is better to fix the minimum percentage above which all profits will be taxed. In, for example, the United States (which followed Canada's plan) pre-War profits were disregarded. A tax on the net income of partnerships and corporations in excess of 8 per cent of the actual capital invested was imposed. To this we shall again refer.

In order not to affect detrimentally production, the normal rate of profits should not be pitched at too low a level. Evasion and wasteful production may take place unless the rate of duty is kept low. It is said that excess profits duties stimulate extravagant expenditure on account of the fact that allowances are made for expenditure. This has sometimes been taken as a reason which counteracts the splendid productivity of such forms of taxation. Other criticisms of the tax were (1) that it was limited to a small number of business concerns and therefore was unequal; (2) the tax was said to be complex; (3) it was also alleged to be uncertain; (4) that it pressed more heavily on such industries as construction, manufacturing, and mining than it did on companies with more stable earnings such as banks; and (5) that the tax was passed on with additions to the consumers. These reasons have only to be stated in order to show their invalidity. Provided the tax is not pitched at too high a level and has normal exemptions and reliefs with efficient administration, this form of taxation of surplus is undoubtedly good. Had there been a duty or not, full monopoly prices would have been imposed, and it was only when the duty gave an opportunity for charging more by the threat of checking supply that it raised prices directly.

The taxation of surplus in this form in Great Britain was first done, as already noted, under the Munitions Levy, or more correctly the Munitions Exchequer Payments. The Munitions Levy was imposed on controlled establishments as a bargain between labour, capital, and the State for the production of war materials. Labour accepted certain conditions prejudicial to its interests for the sake of increased production, and capital in its turn agreed to hand over to the State its profits in excess of the average of the two pre-War years plus one-fifth of the same profits. This levy was restricted to certain controlled concerns only, but these were liable to the excess profits duty subsequently imposed or the Munitions Levy, whichever was higher. The Munitions Levy ceased with 31st December 1916. The excess profits duty was imposed by the Finance Act of 1915 with the definite object of raising revenue, and unlike the Munitions Levy affected all trades and businesses, including agency, carried on inside or outside the country by those persons who were resident in the United Kingdom. Agriculture, offices, or employments, professions and commercial travellers were exempted from the scope of the tax.

The normal standard was based on the average profits of the business in two out of the last three pre-War years. Where there had been only two years of pre-War trading, the standard was the average profits of those two years. Where there had been only one year of pre-War trading, the standard was of that year. If there were no pre-War years a statutory percentage upon the capital employed was taken. Assets were valued at cost after allowing for wear and tear, investments outside the business were excluded, and debentures and other loan capital were deducted as liabilities from the assets. After the 31st December 1919, £500 was added to the percentage standard for each proprietor working full time in the business. The percentage rates for companies and other corporate bodies were 6 up to the 31st December 1916, and after that date in the case of business having one or more pre-War years, 6 per cent. In the case of a business having less than one pre-War year, or a business commenced since the War, 9 per cent increased by 2 per cent for accounting periods after 31st March 1919 was fixed. In the case of private companies these were 7, 8, and 11 per cent, in the last case increased by 2 per cent for accounting periods after 31st December 1919. Special percentage rates were granted, not to individuals but to trades as a whole, by a Board of Referees specially appointed by the Treasury. The differentiation between private firms and corporate bodies was made in order to equalise the incidence of the duty. Remuneration paid to the directors and managers of corporations was deducted from profits, but no deduction on account of remuneration to proprietors or partners was allowed in private businesses. Certain classes of trade to which special risk attached were given an increased percentage rate, and the profits of companies were computed on the same principle as for income-tax purposes, with certain exceptions. Income derived from investments (except in the exceptional case of investment concerns) was excluded from the computation of profits. The exceptions were (1) a deduction on account of interest on borrowed money, (2) the restriction of the remuneration of directors and managers to the amount paid in the pre-War year unless the Commissioners of Inland Revenue decided otherwise, (3) allowances in respect of depreciation and postponement of repairs due to the War, and (4) adjustments according to the variation of capital in the pre-War years and in the subsequent accounting period.

A statutory allowance of £200 for every business, subject to a maximum of £800 for small businesses, was made before fixing the excess profits. Profits below the standard in any one accounting period could also be set off against the excess profits in another. This right was denied to the successors of the business owners, but the Finance Act of 1922 extended the privilege to cases where the successor was the husband, wife, ancestor, or lineal descendant of the previous owner of the business. The rate of duty was as high as 80 per cent from 1st January 1917 to 31st December 1918. It was never lower than 40 per cent, the rate during 1919. When the duty was discontinued from 1921 it was arranged to allow relief in respect of a heavy drop in the values of traders' stocks. In no case was liability for duty to continue after the 4th August of that year. The Finance Act of 1922 provided that the payment of the outstanding arrears of excess profits duty might be spread over five years of quarterly instalments with simple interest at $4\frac{1}{2}$ per cent per annum. The duty was collected by the Commissioners of Inland Revenue, and payment was made two months after the notice of assessment, although the Commissioners were empowered to accept payment by instalments in suitable cases. Discounts at varying rates were allowed on pre-payment, and certain Government securities issued during the War were accepted in satisfaction of the duty. Although the administration of the Act was centralised in the Commissioners of Income Tax, the main work was entrusted to H.M. Inspectors of Taxes. Certain rights of appeal were permitted to the General Commissioners of Income Tax and to the Special Commissioners of Income Tax, and on points of law either party might appeal to the courts of law on certain specific points of dispute. There was a Board of Referees appointed by the Treasury, from whom also there was an appeal on points of law to the courts.

The Excess Mineral Rights Duty was complementary to the Excess Profits Duty, and was levied at the same rate. The owners of mineral royalties were taxed on the excess over the royalty paid in the pre-War years. The duty was only imposed in those cases where the rate of mineral royalty varied according to the selling price of the minerals.

In New Zealand the excess profits tax was brought into operation in 1916. This was found inequitable and otherwise unsatisfactory, and a system of progressive land taxation, together

with a higher income tax and a new special War tax on incomes over a fixed amount, was adopted in 1917. The War Time Profits Tax of Australia came into force on 22nd September 1917, and ceased to exist on 1st July 1919. The standard for calculating the excess profits was taken to be either the average profits of two of the three years before 4th August 1917, or 10 per cent of the capital employed in a business. The year of assessment was the War-time financial year 1st July to 30th June. For 1915-16 the rate of tax was 50 per cent, and for subsequent years 75 per cent. Legislation based on similar principles was enacted in the other Dominions, but was temporary only.

In India, under the Act of 1919, income from agriculture, offices, or employments and professions mainly dependent on personal qualifications were exempt from liability to excess profits duty, as also any business paying similar duty in the United Kingdom or of which the profits did not exceed thirty thousand rupees. The duty leviable was 50 per cent of the amount by which the profits in the accounting period exceeded the standard profits which were ordinarily calculated at the rate of 10 per cent of the capital of the business. The assessee, however, could exercise the option of calculating the standard profits according to certain prescribed methods. The collector was entrusted with the power of making allowances for special circumstances caused by a change in the constitution of the partnership, postponement of renewals, and repairs owing to the War, exceptional depreciation, etc. The amount charged as excess profits duty was deducted from profits before assessing income tax, as in Great Britain. Excess profits duty was not levied if super-tax was charged. The higher of the two taxes alone was chargeable.

In the United States the excess profits tax was confined at first to profits directly traceable to war, but it was later on extended to all concerns.¹ The tax, as has been noted, was levied on profits in excess of 8 per cent of the actual capital, with an exemption of \$6000 for individuals and partnerships and \$3000 for corporations. Profits below 20 per cent, but above this minimum of the invested capital, were taxed at 20 per cent, and those in excess of 20 per cent at 40 per cent. The tax extended

¹ Excess Profits Tax (Act of 3rd March 1917); War Excess Profits Tax (Act of 3rd October 1917); War Profits and Excess Profits Tax (Act of 24th February 1919). The law was repealed on 23rd November 1921, and the taxes were discontinued from 1st January 1922.

to all trades and businesses, including professions and occupations, but beginning with 1918 the tax was only confined to corporations, excluding personal-service corporations (*i.e.* those whose income is to be ascribed primarily to the activities of the personal owners or stock-holders who are themselves regularly engaged in the active conduct of the affairs of the corporation, and in which capital, whether invested or borrowed, is not a material income-producing factor), which were taxed substantially as partnerships. The object of this was that, as the American income tax falls more lightly on corporations than upon other taxpayers, the tax should fall equally. Under the income tax the entire income or profit of an individual is subject to normal tax and surtaxes, which extend to as high as 50 per cent whether the income is spent or reinvested, but the corporation does not pay income surtaxes, and its stock-holders only pay surtaxes on the profits which are distributed. It was repealed in 1921, as, according to the Secretary to the Treasury, it encouraged wasteful expenditure, put a premium on over-capitalisation and a penalty on energy and enterprise, and it confirmed old undertakings in their monopolies. The duty as levied in the United States was indeed open to these criticisms.

The taxation of windfalls brought, as we have seen, considerable revenues to national exchequers. In the War and for several years afterwards, when abnormal profits and unusual fortunes were made, governments took back in the form of war profits and excess profits taxes what was in reality part of the excess price which they had paid to manufacturers mainly for war goods. Very heavy excess profits taxation of this sort tends to prevent price inflation, but, on the other hand, there is the danger of seriously interfering with production and the incentive leading to that production. In the future fiscal authorities in most countries will impose taxes of this nature when circumstances arise to produce abnormal profits. Theoretically the taxation of windfalls should allow for changes in the price-level, changes in the general rate of interest, as well as anticipated increments. Even with index numbers handled with care it would be difficult, if not impossible, in practice to make these allowances. There are also difficulties in fixing the rate of tax, such as the normal return to be allowed on the invested capital, and the rates of tax for various industries. Experience has shown that in future it will be well

to neglect the allowance for changes in the price-level, interest, etc., and merely to take into the taxation net those increments which are exceptionally large, such as war profits and excess profits at 1916 and 1922. "It is still possible," as Pigou¹ has pointed out, "at the expense indeed of letting some real windfalls go free, to avoid any serious risk of taxing increments that are not windfalls by the simple device of exempting all increments other than those which are very large." In this class of windfalls war profits and excess profits belong.

¹ Pigou, *Public Finance* (Macmillan, 1928), p. 184.

CHAPTER XXV

SALES OR TURNOVER TAXES

1. As a result of the financial stringency created by the World War, the fiscal authorities of various countries had recourse to a new source of revenue in the form of sales or turnover taxes. The rediscovery of sales taxes has indeed been one of the most striking features of post-War fiscal policy, as it has been highly successful from the standpoint of revenue.¹ The term "sales tax" or "turnover tax" may refer to a general tax on all sales or only on particular commodities. It may, as in France, include services, fees, commissions, interest, and other payments. A distinction is sometimes made between a sales and a turnover tax in that the latter refers to services as well as commodities, but there is in reality no clear distinction. The term "sales tax" is more common in America and "turnover tax" in England. The French tax is known as "*l'impôt sur le chiffre d'affaires*", and the German as "*die Umsatzsteuer*". These taxes were at first payments taxes introduced in Germany in 1916 and in France in the following year. The French taxes consisted chiefly of a 10 per cent luxury tax, a general tax on retail transactions, and a higher tax than formerly on receipted payments. It was collected by stamps, abandoned in the turnover tax, and there was considerable evasion as the administration was not equipped, as indeed it

¹ The following works may be consulted: Grabower, *Die Geschichte der Umsatzsteuer* (Berlin, 1925); Allix and Lecerclé, *La Taxe sur le chiffre d'affaires* (2nd edit., Paris, 1929); National Industrial Conference Board, *General Sales or Turnover Taxation* (New York, 1929); Shoup, *The Sales Tax in France* (New York, 1930) and *The Sales Tax in the American States* (New York, 1934); Buehler, *General Sales Taxation* (New York, 1932); Comstock, *Taxation in the Modern State* (New York, 1929); Seligman, *Studies in Public Finance* (New York, 1925); Popitz, "Kommentar zum Umsatzsteuergesetz", *Die deutschen Finanz-und Steuergesetze in Einzelkommentaren*, vol. xi. (Berlin, 1928), with Supplement (1930).

was not for some years later, to collect the tax in such a way as to avoid evasion. These payments taxes on retail sales were superseded in Germany in 1918 and in France in 1920 by sales or turnover taxes on the total receipts of business and not merely on retail sales. It has been found in France that the system of affixing stamps to books and receipts was costly ; merchants had to pay the money to the Treasury before it was really due, and there was risk of loss through negligence on the part of employees in the handling of the stamps. Far more important was the evasion that was possible, and therefore the collection by stamps which took place under the payments taxes gave place to the returns furnished periodically. In the turnover tax, as collected in France, the tax collector is able to make a systematic and thorough inquiry of the special register of sales or transactions subject to the tax, ledgers, records in regard to customers' accounts and to make copies of these, and also to inspect where necessary bank records for the purpose of checking doubtful points. This new form of taxation has spread rapidly throughout the world until at the present time, apart from the states of the American Union, there are some thirty nations which have enacted such taxes.¹ The sales tax has become a rival to customs and even income taxation in several countries, as will be seen from the following table :

INCOME, CUSTOMS, AND SALES TAX REVENUE EXPRESSED IN PERCENTAGES

Country.	Year.	Income Tax.	Customs.	Sales Tax.	Total.
France . .	1934	19.5	15.1	17.5	52.1
Germany . .	1932-33	9.4	22.3	19.1	50.8
Italy . .	1933-34	22.3	11.7	6.6	40.6
Hungary . .	1932-33	10.6	4.8	12.9	28.3
Czechoslovakia .	1933	14.6	6.5	23.0	44.1
Austria . .	1934	19.4	16.0	21.2	56.6

Sales taxation is, of course, of ancient origin. It was collected in Athens, in Egypt by the Ptolemies and by the Romans, in Rome by Augustus and later emperors. It was carried to Spain

¹ For details of the sales taxes in the American Union see Shoup, *The Sales Tax in the American States*, and table in *Tax Systems of the World*, 6th edition, 1935 (Corp. Trust Company, 205 W. Munroe St., Chicago), pp. 136-39, where the nature of the tax in 32 states is described as on 1st October 1935.

and France and survived for a long period after Roman rule had disappeared. This form of taxation was in existence among local communities in Spain almost from time immemorial, and it was introduced as a national tax in Spain in 1342 and was not abolished until 1845. It was called the Alcavala, and was criticised by the author of *The Wealth of Nations* for its costliness of collection and for the inconvenience which it gave to the taxpayer. Adam Smith, had he been with us to-day, would have referred to the high rate of tax at the time when he wrote as compared with the rates of the recently rediscovered sales and turnover taxes. In France sales taxes were known such as that on the sales of provisions imposed in 1314. During the fifteenth century and subsequently sales taxes were collected in the kingdom of Naples. During the nineteenth century a few states of the American Union adopted sales taxation, but it was not until after the War that this form of taxation has become entrenched in the tax structure of many countries. Much revenue has flowed into national exchequers in small payments without much effort or complaint, and this popular form of taxation is already to be found in many important countries, as will be seen from the following table :

GENERAL NATIONAL GOVERNMENT SALES TAXES IN VARIOUS COUNTRIES

NOTE.—This table refers to National Sales Taxes only and excludes accordingly sales taxes levied in 32 of the states of the American Union.

Country.	When established	Rate (as on 1st Jan. 1935).	Payment of Tax.	Basis.*
France .	1920	2% on ordinary articles ; special rates for special industries ; 3%-16% on luxuries	Monthly for larger, annually for smaller taxpayers	Total turnover
Germany .	1919	2%	Annual	Total turnover
Belgium .	1921	2.5% ; special rates for certain articles	Monthly	Sales of commodities except at retail
Italy .	1919	2.5%	Monthly	Sales of commodities except at retail

* For details see text.

GENERAL NATIONAL GOVERNMENT SALES TAXES IN VARIOUS COUNTRIES—*contd.*

Country.	When established.	Rate (as on 1st Jan. 1935).	Payment of Tax	Basis.*
Austria .	1923	Generally 2%–8% but varies with classes of commodities	Annual †	Total turnover
Hungary .	1921	2% on ordinary articles; 10%–25% on luxuries; various rates for special industries	Annual	Total turnover
Poland .	1925	½% to 5% special rates for special articles and for luxuries	Monthly for larger, and quarterly for smaller taxpayers	Total turnover
Russia (U.S.S.R.)	1921	Varies according to classification	In 5 instalments annually	Total turnover
Canada .	1920	6% ‡	Monthly	Sales of producers, manufacturers, and importers only
Australia .	1930	5%	Monthly	Sales of producers and importers only
New Zealand	1933	5%	Monthly	Sales of wholesalers and manufacturing retailers
Philippine Islands	1904	1%–1·5%	Quarterly	Sales of merchants, manufacturers, receipts of printers, publishers, contractors, public utilities, etc.

* For details see text.

† As far as may be ascertained.

‡ Raised to 8% from 1936.

Even in Great Britain and the United States suggestions have been made to introduce sales taxation as national taxes and as a substitute for part of, or as an addition to, the existing taxation

on income. In Great Britain the tax has never been popular mainly because it is thought to be a burden on business, that it leads to a rise in prices and consequently to wage disturbances, and that it is passed on to the consumer, points which have not always been capable of proof. The Colwyn Committee dismissed the proposal of sales taxation in somewhat cavalier terms and in a single paragraph in its Report.¹ The grounds were that a tax on income was preferable and income taxation is borne by the person paying the tax and is not passed on in prices to any degree ; the tax would be harmful to industry as it would lead to higher costs, and this would aggravate competition specially in those industries where foreign competition is keen ; the British taxpayer is willing to bear a large annual burden of direct taxes which, unlike general sales taxes, are graduated according to ability. In the British system, too, there is already a large burden on small incomes from indirect taxation. Several of these reasons, as will be shown, do not give full justice to the arguments and experience of the sales tax. In 1931 a Federal sales tax of $1\frac{1}{2}$ per cent on retail sales was suggested by Senator David Reed of Pennsylvania as a means of raising additional Federal revenue to the extent of 2000 million dollars. It has, during the great trade depression, 1929-35, been suggested as a Federal tax on more than one occasion.

SCOPE OF THE TAX

2. The tax may be general, as in France or Germany, or retail transactions may be excluded, as in Belgium. It may be, as is common in the states of the American Union, confined to retail transactions. It may be imposed, as in Canada and Australia, as a producers' or manufacturers' tax, and it may be on classified industries or trades only. It may be levied on nearly all goods and services, as in Germany. It may exempt certain sales, as in France, where the sales of farmers are exempted unless they are carrying on manufacture as well as agriculture. Articles such as flour, sugar, tea, coffee, fertilisers, the slaughtering of cattle, sheep, pigs, and horses, and coal, under the French legislation, are exempted from the domestic turnover tax but are subject to replacement taxes levied upon these articles at one of the early stages

¹ Report of the Committee on National Debt and Taxation (Cmd. 2800, 1927, para. 1031).

upon sale by the manufacturer. In France, too, low-priced newspapers are exempted. Practically no regard is given to the small seller or small sales in Germany, while in other countries, such as Belgium, sales below a certain limit are immune from sales taxation. Under the Belgian law sales costing 30 frs. or less, and in the case of agricultural or coal-mining products sales of the value of not more than 150 frs., are exempted. The ordinary rules of the turnover tax in regard to payment and control are applicable, it may be noted, to these replacement taxes. Exports are usually exempted in order not to discourage foreign trade. In Germany and Canada, for example, the sales taxes paid on exports are remitted in whole or in part. Germany repays the amount paid on the last sale before exportation. Canada repays 99 per cent of the tax paid on goods exported, and since 1926 the taxation of exports has been exempted in France. Sales taxes on exports, it is said, place the producing country at a disadvantage as compared with other countries which have no sales taxes or have lower rates. From this it is sometimes argued that exporters have to compete with foreign exporters who pay no sales taxes, and that in such a case the sales tax cannot be shifted to foreign markets. Where one state employs a sales tax while a neighbouring state does not, as in some states of the American Union, this might be a serious matter. On the other hand, it is unlikely that a sales tax really encourages foreign products in the domestic market by placing domestic concerns at a disadvantage as compared with foreign businesses. It is often forgotten that foreign competitors may have to pay other taxes and to meet higher wages and other costs which are heavier than sales taxes and that a sales tax is only one factor in the problem. The imports of raw material are also sometimes exempted from the sales tax, as in France by the law of June 1925, and in order to relieve French manufacturers working with raw materials purchased through importers the law exempts from the turnover tax the first sale of those goods made after landing on French soil. The list includes hides, wool, silk, cereals, rice, coffee, rubber, cotton, flax, hemp, jute, cocoa, and natural phosphates. Imports which compete with domestically taxed goods are subject to an extra tax known as the import tax, not to be confused with the ordinary customs duties. In short, the rates on sales of imported goods may sometimes be above those produced within the country in order to protect domestic enterprise.

from foreign competition. Under the Canadian law, imports by consumers or retailers are taxed at a higher rate than if the goods had been produced in the country. Importation manufacturers or wholesalers are taxed at a lower rate than importations by retailers or consumers. Germany levies sales taxes after importation with certain exceptions. In regard to the taxation of services Germany makes no exceptions except in regard to medical services paid from trade union or public funds. In France doctors, lawyers, accountants, headmasters, and other professional men who do not buy and sell are exempted. They must, however, take care not to do commercial acts. If a doctor were to run a sanatorium and to make a considerable amount from the board and lodging of his patients, he would be liable for the tax. These classes were omitted from the turnover tax chiefly because of the fact that when the legislation came into force the income-tax administration was having considerable trouble in regard to the estimation of income of these classes, and it was considered inadvisable to raise difficulties by including such receipts within the turnover tax. In theory, too, it was believed that the tax was always shifted to the consumer, and therefore it was impolitic to tax professional men with business men.

The tax is not so difficult to collect or to evade as is sometimes imagined, owing to the keeping of books even by small traders, and where books are not kept an estimated tax may be, as in France, quite workable. National sales taxes are collected usually through the ordinary administrative machinery. The collection of the tax does not involve the same intricacies of accounting as in the case of the income tax, and the tax brings in more revenue per head of expenditure on tax administration than does the income tax. The sales taxes are usually 1 or 2 per cent and vary from a fraction of 1 per cent to 6 per cent or higher. The rates may vary with the volume of sales or with the classes of taxpayers, or with commodities and services. Luxury sales taxes are collected at higher rates than ordinary sales taxes, the customary returns being from 5 to 15 per cent. The examination monthly of sales registers, ledgers, and other sources of information tends to curtail very considerably evasion. In France there is the annual *forfait* or estimated tax basis by which a large number of taxpayers on application and when permission is granted need not keep any record of sales but pay the turnover tax on an estimated basis

which the tax-collector fixes after checking the available external indices of taxable capacity in this connexion. A manufacturer's or wholesaler's tax is easier to collect than a general sales tax, and less evasion is therefore likely especially if these manufacturers are licensed, as in Belgium. The mere fact that the tax is levied on a relatively small number of taxpayers whose sales are large is an advantage in collection, and this is specially the case where manufacturing is extensive.

The greatest indictment brought against the sales tax is its encouragement of the integration of industry and its influence in changing methods of business. It is argued that the single-process manufacturer is at a disadvantage with the larger manufacturer of finished goods, who combines with the manufacturers of semi-finished goods and the producers of raw materials and thus pays less sales taxation. In the marketing, therefore, of his goods he has an advantage over the small single-process competitor. Similarly a business which develops its own selling organisation has an advantage over that which must deal with the wholesaler, commission merchants, and brokers, so that in the end the latter would tend to be eliminated. This argument that a sales tax tends to reduce integration or vertical combination in industry has been used by opponents of sales taxes in various countries. The small-scale manufacturer may be exempted in certain cases from a turnover tax and a tax in the form of a business licence tax imposed in its place. Those who pay the turnover tax would be exempted from this licence tax. Germany and Belgium try to protect the middleman by providing that when a sale forms one of a series and the seller never has the goods in his immediate possession the transfer is not taxable. The argument that a sales tax tends to reduce integration in industry was an assumption of the legislation in Germany, Belgium, and some other countries. It has not been proved, however, although integrating effects have been noted in one or two instances. With a very small difference in costs of, say, 1 per cent or 2 per cent, it is unlikely that the sales tax could have the effect which the opponents have alleged. Single sales taxes on producers or on retailers avoid the stimulation to integration. National producers' taxes, however, are administratively to be preferred to retailers' taxes. They are easy to administer and do not have an integrating influence.

A third criticism against the tax is that it may discriminate

to the disadvantage of the poor because it is shifted and becomes a tax on expenditures. It is, in other words, very regressive. The poorer classes in a community spend proportionately a larger part of their incomes on articles of necessity and save less than the wealthier classes. The tax, it is urged, like other indirect taxes, is contrary to the precepts of modern fiscal theory. Gross expenditures are not a suitable basis of taxation, and therefore a sales tax is heavier on the poorer classes and unsatisfactory in its distribution of the tax burden. In short, it takes no account of the fact of the source of income and the way in which the income is spent, the number of dependants, or savings from income. This raises the question of the incidence of the tax, which is not so simple as is sometimes assumed. The tax may be separately paid, as in Belgium, by the use of stamps, or it may be added to the invoice. Prices, it is said, rise by the amount of the tax, which is not always the case. When prices are falling it has been found from experience that the assumption that prices rise by the amount of the tax is far from being true. In fact, in France in the recent depression it has been quite clear that the retail merchants have been unable to shift the tax on to the consumer several times over, as was the case when prices were rising. If sales taxes are not shifted, as the sellers may prefer to absorb the tax specially if it is not severe, rather than to interfere with customary prices, the tax remains with business as a charge on sales. If the tax is shifted, sales may decline and readjustments and supplies may be necessary. The shifting would depend upon the nature of the demand and other factors contributing to its price. In times of falling prices there is a decided tendency for producers or dealers to absorb the tax. If it is not shifted, it is therefore paid out of producers' or dealers' profits and its burden varies from industry to industry. If an industry or business works on a small profit, even a moderate sales tax would have a decided effect in comparison with a slower turnover and a higher rate of profit on that turnover. The concern which is organised by vertical combination would have to add a small amount to its price in comparison with firms in other types of industry, as has already been noted.

Luxury taxes are only supplementary to sales taxes and are therefore not sufficiently heavy to counterbalance the effect of sales taxes on the poorer classes. In many cases, too, the richer classes have the advantage that services supplied by house servants

are exempt from sales taxes. On the other hand, the richer classes have to pay progressive taxes in the form of income tax, super-tax, and inheritance tax. The superimposing of luxury taxes on the general sales taxes has, although supported by public opinion, not been altogether successful. The taxes are on retail sales and on the gross receipts of certain hotels and restaurants. Certain tax interests have opposed the tax because it is alleged that it checks the production of luxury articles. The Paris Chamber of Commerce in 1922, for example, objected to the tax because it restricted demand and led to a considerable amount of fraud in evading the duty by invoices. For example, two suits may be invoiced at 300 frs. in place of one suit at 600 frs. plus 10 per cent luxury tax, or one suit may be entered at 300 frs. plus 300 frs. for services to the purchaser which the tax collector could hardly check. The tax was levied on goods considered to be *de luxe*, while others became luxury goods only when sold at a certain price. When prices alter, the lines demarcating luxuries from non-luxuries have to be readjusted, and this sometimes, by delay or otherwise on the part of Government which notifies the change, gives rise to difficulties. In the taxation of hotels and restaurants the fixing of a standard of luxury has given rise to considerable difficulty. "I know", said a member of the Chamber of Deputies in 1920, "a hotel in Toulouse in which 75 per cent of the travelling salesmen pay 16 frs. a day for board and lodging. This hotel pays the *de luxe* tax because its windows face the Place Lafayette, which is considered a luxurious location!"¹ Germany, on account of the difficulties connected with the luxury tax, abandoned the special taxation of luxuries altogether.

The proceeds of sales taxation are used exclusively by national governments in Canada, Australia, New Zealand, Belgium, and Italy. In other countries these taxes are shared. Thus in Germany 70 per cent of the proceeds of the turnover tax goes to the Reich and 30 per cent to State and local governments; in France 90 per cent to the National Exchequer and 10 per cent to local governments; in Austria 60 per cent to the National Government and 40 per cent to local governments. State governments in the United States as a whole use the proceeds for the State General Fund, but in a few cases the proceeds may be in part diverted to local authorities. In Connecticut, for example, 50 per cent goes

¹ Shoup, *The Sales Tax in France*, p. 173.

to the State and 50 per cent is distributed according to population among local authorities. This, however, is the exception rather than the rule. Local governments sometimes collect sales taxes for their own purposes, and national governments may permit a local supplementary tax.

SALES TAXES IN VARIOUS COUNTRIES

3. It will be convenient to summarise briefly some of the outstanding characteristics of sales-tax legislation in the principal countries. In Germany the scope of the tax is very wide. It applies to sales of goods and services although certain foodstuffs, raw materials, certain necessary imports and also exports are exempt from the tax. A secondary characteristic of the German turnover tax, noticeable also in that of France, is the statutory requirement of keeping details of the transactions liable to the tax, and also the requirement by the tax authorities that the taxpayer should notify his liability. Careful records of daily transactions, goods and services, on which the tax is based are essential. A tax-book showing the details of goods sold, the prices at which they were sold, and the date of sale, and a stock-book are kept. A quarterly return is made and an advance payment made on these quarterly sales. Adjustments are made at the end of the year. A third characteristic is the great productivity of the tax, which has been a boon to Germany, especially in the period of depreciating currency when the Reich could not rely on income and inheritance taxes. In 1932-33 the proceeds of the general sales tax were 1349 million marks out of a total tax revenue of 10,280 millions. This tax was exceeded only by the income tax and inheritance taxes and was approximately the same as the revenues from customs and that from the sugar tax. The present rate of tax of 2 per cent has been in existence since October 1924. One per cent only is charged on the turnover of agricultural produce, flour, and bakers' produce. For retail firms with a turnover of more than one million reichsmarks the rate is $2\frac{1}{2}$ per cent. The luxury tax, to which a reference has already been made, was at first levied at the rate of 15 per cent but subsequently reduced to 10 and $7\frac{1}{2}$ per cent. The luxury tax was abolished from April 1926.

The chief characteristics of the French sales tax are the pro-

ductivity of the tax, the administration and control now exercised by the taxing authorities, and the existence of a luxury tax, replacement taxes, and the method by which imports and exports have been worked into the system. The normal rate of tax is 2 per cent, the rate on luxuries varying from 3 to 16 per cent. In 1935 the turnover tax, which applied to all transactions, was replaced by a single tax collected usually at the time and place of production in the case of coal, sugar, foodstuffs, beer, and a few other articles. A single tax on the slaughter of animals and on pharmaceutical preparations also took the place of the usual turnover tax. In the year ending December 1934 the turnover tax, apart from the luxury taxes (which reached the comparatively unimportant sum of 234 million frs.), produced approximately 6 milliards of francs out of a total national, provincial, and local tax revenue of 49 milliards. The tax was more prolific than any other tax in that year, with the single exception of the income tax, and the year in question was a year of the great depression. It exceeded the customs revenue, which was over 5 milliards. After the unpopular period which all turnover taxes go through in their early stages, the collection of the tax was not so difficult as at the beginning, largely on account of the fact that under the Code Napoléon everyone engaged in commerce and industry has to keep accounts of his transactions day by day and his assets as well as liabilities. A record must be kept of all transactions subject to the tax in a special register, and when required they not only have to show the sales book but also larger accounts of general merchandise, cash, and accounts receivable. These registers have to be preserved for at least three years. Cash sales omissions are the most common method of evasion, but the total sales may be checked against total purchases made by the retailer, especially in the case of small retailers where the stock on hand is small. The concession to the small tradesman which was made in 1922 by the *forfait* or annual lump sum payment is also a characteristic of the French turnover tax. It was introduced for the benefit of small grocers and other small traders and for street hawkers who kept no accounts. The *forfait*, it is sometimes overlooked, still requires control and other work on the part of the taxing authority. The outstanding feature of the *forfait* is that certain taxpayers whose turnover is below a certain sum annually receive on application the benefit of this method of assessment

and collection. It obviates the accurate recording of turnover and the inspection of books and also the periodical payments. The taxing authority has a variety of ways of checking the request for the *forfait*. He notes the rent paid by the tradesman and compares him with payers of the turnover tax in similar circumstances, he uses data of his purchases from books of "non-*forfait*" taxpayers, he looks to his family and social standing and he applies a profit coefficient used in levying the income tax to his estimated turnover in order to see whether the applicant has underestimated his turnover. From the viewpoint of revenue the turnover tax has been undoubtedly successful as it brings a large and speedily collectible revenue and it seems now secure in the background of French public finance.

The interest of the Belgian sales tax is its success in a country where democratic taxation on the lines of England and the United States has long been adopted. It is collected by affixing double stamps, one half of which is placed on the seller's invoice and one half on the purchaser's invoice and by the cancelling of these by the seller. This method avoided the increase in administrative machinery to the extent that was necessary in France. The usual rate is 2·5 per cent with variations according to commodities. It is similar to the Canadian tax as it is levied on manufacturers and wholesalers and not on retailers. Goods must be transferable if they are subject to the tax; commodities of food, imports, and sales of gas, water, and electricity are exempt from the tax. The Canadian tax, which is similar, was levied in 1920 as a sales tax of 1 per cent on wholesale traders and manufacturers. The following year this was raised to 1½ per cent on sales by wholesalers, manufacturers, and jobbers, and from 2 to 3 per cent in the case of direct sales by the manufacturers to retailers and consumers. This differential return is of interest as it tends to make the tax bear equally on all persons in the same class. A manufacturer selling directly to the consumer and dispensing with the wholesaler would thus pay double the ordinary tax which he would have paid if he had sold to the wholesaler, who in turn would have paid at the next transfer. The additional tax levied on imported articles has already been referred to. The maximum rate of tax is now 6 per cent on the sale of goods liable to tax. Certain goods are totally exempt, while others are subject only to 50 per cent of the ordinary tax. The tax, which is paid by nota-

tion on the invoice, is productive and also comparatively easy to administer and collect as it is a wholesale tax and not a general turnover tax. It rivals the income tax in yield, being in the year ending March 1922 \$59,606,000 as compared with \$61,254,000 in the case of income tax out of a total Dominion tax revenue of \$275,053,000. The Canadian sales tax was copied by Australia in 1930. Like the Canadian tax, it is bringing in to the Commonwealth Government a considerable sum of revenue. Although a new tax, it produced for the year ending 30th June 1934 £8,696,000 as compared with £9,315,000 for income tax, £11,928,000 for excises, and £22,327,000 for customs duties out of a total tax revenue of £56,409,000. The tax applies to the sale of commodities by producers and importers and the rate is 5 per cent. As in Canada, monthly returns of sales together with the amount of the tax payable are submitted every month. Certain goods such as food-stuffs, dairy produce, sugar, coal, cigarettes, newspapers, wool-packs and imports of petrol, tobacco, films, and wireless goods which are subject to special import duties are exempt. Provision is made for allowing adjustments for bad debts in regard to which the sales tax has been paid. In the case of imports the tax is levied at the time of importation, except in the case of licensed wholesalers or manufacturers, on the aggregate of the value for customs duty plus a duty of 20 per cent which is subject to adjustment when the goods are actually sold. In the case of licensed wholesalers or manufacturers, the tax is levied when the goods are sold to the retailers or consumers. These licensed wholesalers or manufacturers pay the tax at the end of every month when they submit a return of their sales.

This survey of the sales tax shows that it is practicable and productive in certain circumstances. Its productivity in times of emergency makes it a tax which, if the administrative machinery can be made available in order to avoid evasion, and if the tax is kept within moderate limits, will bring into the Treasury a large revenue. The tax is especially suitable in the case of a country like France where high direct taxation is not looked on with favour. The tax, however, should not, in spite of its productivity, be regarded as a substitute for the income tax or selected excises, but as a tax which should go side by side with a progressive income tax and such excises.

CHAPTER XXVI

CUSTOMS DUTIES

GENERAL ECONOMIC CONSIDERATIONS

1. SEA and land customs duties are earlier in origin than excise duties. In Adam Smith's words, "The duties of customs are much more ancient than those of excise. They seem to have been called customs, as denoting customary payments which had been in use from time immemorial. They appear to have been originally considered as taxes upon the profits of merchants."¹ These are like excise taxes upon consumption and are levied usually on imports, but also, to a less extent, on exports. In the Roman Empire we read of customs duties in the provinces which usually did not exceed 5 per cent *ad valorem*. In mediaeval Europe we find export duties and later import duties as a source of revenue. For a long time special customs were levied on goods passing between England and Scotland. The transit duty may, in fact, be regarded as it is to-day between British India and Native States as a customs duty. The ruling prince or chief charges duties on goods passing into his state, not merely for services rendered, such as protecting the goods of the importer or exporter, but as a source of indirect taxation.

In Anglo-Saxon England we know that the king made a levy on goods through his sheriffs for the maintenance of the Royal Household, and he probably had some revenue from foreign trade. The merchant, speaking of the dignity of his profession, mentions that he is "useful to the king and his nobles, to rich men and to common folk". In later years, subsequent to the Norman period, the king fixed duties on the export of wool fells (*i.e.* skins with the wool on them) and

¹ Book V. ch. ii. part ii. art. iv. (Cannan edit. vol. ii. p. 362).

on leather. In the Magna Charta these were called "the ancient and equitable duties" as compared with those on wine known as "the new customs". Tunnage and poundage were levied first in the time of Edward I. (1302), and were fixed at 3d. on every pound of merchandise and 2s. on every tun of wine imported, also at various rates on exports. Customs subsidies were granted for short periods in addition to the hereditary duties and the life grant of tonnage and poundage.¹ We shall see below how these duties were levied to promote, especially in the eighteenth century, home manufactures.

Export duties were levied, as it was frequently thought that the foreigner would pay the tax. They were sometimes imposed in order to prevent exports. Export duties were first imposed by statute in England in 1275 and applied to wool and hides. From the thirteenth to the middle of the seventeenth centuries they rapidly increased in Europe both as a source of revenue and as a means of preserving the supply of food grains and raw materials for internal consumption. Their popularity may be illustrated from the fact that by 1660 there were in England 212 articles subject to export duties. Owing to the teaching of the mercantilists in the seventeenth and eighteenth centuries export duties became less popular, as such duties were held to restrict exports, and were confined mainly to raw materials as mercantilist policy encouraged exports of manufactured goods. With the rise of free trade in the nineteenth century export duties disappeared in Europe, and at a much earlier date in America. They were prohibited by the American Constitution chiefly owing to pressure from the South, which did not wish the export of its agricultural products to be interfered with. They disappeared in England in 1842, in France in 1857, and in Prussia in 1865. To-day export duties are no longer so unpopular. These duties are at the present time limited to raw materials mainly for preserving the supply of raw materials for the domestic producer, as in the case of exports of cork from Spain and Portugal, and timber in Scandinavia and in British Columbia. They are sometimes imposed partly to conserve the natural resources of a country, as in the case of the Scandinavian export duties and also the Canadian embargoes on

¹ Vide *The Early English Customs System—a Documentary Study of the Institutional and Economic History of the Customs from the 13th to the 16th Century*, N. S. B. Gras (Harvard Univ. Press, 1918).

pulpwood. They are, too, levied for revenue purposes. In Central and South America they are imposed almost on all exports and range from 1 per cent to 5 per cent and in some cases exceed 10 per cent. Such countries imposing export duties for revenue purposes are the Argentine, the majority of the Brazilian States, Uruguay, Peru, Salvador, Hayti, Egypt, Syria, Iraq, Arabia, the Belgian Congo, and in Europe, Portugal and Albania. In such cases the producers bear ordinarily the tax, which is the equivalent of a tax on production. Usually, however, export duties are levied on selected products with a view to producing revenue, as in the case of the export duties of raw jute and rice in India, diamonds in the case of the Union of South Africa, and Chilean sodium nitrate, the export duties on which for many years provided half the total of Chile's revenue, until in recent years the synthetic product and by-product nitrogen greatly interfered with Chile's monopoly. The export duty on Brazilian coffee and the export duty on rubber in British Malaya in 1928 showed the effect of competition from outside sources to such duties. Even where a country enjoys a partial monopoly high export duties cannot be shifted to foreign consumers without competition from outside from the product itself or from a substitute, even assuming that the demand for the article is so inelastic that there is no likelihood of a reduction in consumption. Duties on exports were considerably revived in the two decades following the outbreak of the Great War owing to the enormous growth of economic nationalism, the desire on the part of monopolists to exploit the foreign consumer, and, also, in the case of Germany, Poland, and Austria for the purpose of preventing these countries from losing their supplies of materials while their currencies were depreciating by leaps and bounds and at a rate quicker than the fall in internal purchasing power of these currencies. The revival of export duties for both protective and fiscal reasons led the World Economic Conference in 1927 to pass resolutions recommending that exports of raw materials should not be unduly burdened by export duties, that these export duties should never be used for placing foreign countries using such materials in a position of unfair inferiority in the production of the finished article, and that when imposed for revenue or exceptional reasons they should not discriminate between different foreign countries. No official international action, however, has been taken in this regard except for two

conventions for reducing or removing exports of hides, skins, and bones in a few countries. The main principle of export duties, then, is that the home producer should not be penalised by an export duty, except when there is reasonable probability that the tax will fall mainly, if not entirely, on the foreigner, and when there is no apparent likelihood that the production of the commodity in the country exporting the article will be affected. Export duties for revenue purposes should, in short, be sparingly used, and imposed to a moderate degree only on those articles in which the taxing country possesses a monopoly or quasi-monopoly.¹

For the converse reason import duties are increasingly popular. The advantage to home industry, coupled with the convenience and productiveness of the tax, tends to make import duties more and more prominent in customs systems. A tax on imports, as we have already seen in discussing the incidence of import duties, may fall on the consumers in the taxing country when the foreign producer has alternative markets. If the taxing country is the only market, and if the demand for the article is elastic, the producer may be forced to bear the tax in order to preserve his business with the taxing country, but the supply will, other things being equal, be curtailed until prices recover, except, of course, if monopoly prices have already been in operation.²

There are other economic considerations to be taken into account in discussing customs duties. It is not possible to gain a large revenue from customs duties and at the same time to have protection. An import duty, if it is to be really protective, cannot produce revenue. Similarly, taxes on dumped articles can never be relied on to produce revenue. As Adam Smith said, "Taxes proposed with a view to prevent, or even to diminish, importation are evidently as destructive of the revenue of the customs as of the freedom of trade".³ Some countries, notably India and the United States, have attempted, not very successfully, to combine high protective duties with revenue duties. Protective duties have been placed in these countries on industries to be protected, such as the textile, iron, and steel industries, and in the United States revenue duties on tea, coffee, sugar, and tobacco. If the

¹ For incidence of export duties see Chapter XVIII.

² For incidence of import duties see Chapter XVIII.

³ *The Wealth of Nations*, Book IV. ch. ii.

important consideration is revenue, it is necessary that the commodities to be selected for taxation should be those which are consumed in sufficient quantities to produce the required revenue. In other words, articles which satisfy the ordinary demands of life for the bulk of the population must be placed on the tariff lists. These articles will vary in the case of each country. It is not possible, as suggested by J. S. Mill, to levy customs duties only on articles which are not produced in the country. The question of productiveness and economy, always to the fore with the financier, must receive preference, and the entire list of commodities to be taxed must be planned with care and revised from time to time. It is also at times unavoidable to tax raw materials. Taxes on raw silk, for example, may have the effect of taxing the consumers of silk goods. It will thus be possible to tax in a non-vexatious way the particular class of consumers who wear silk goods.

If the aim is to protect home industries, other points have to be considered. Suppose it is necessary to protect wool and to encourage woollen manufactures. It would be then advantageous to add to the duty upon imported manufactured woollens a compensatory rate, *i.e.* a rate which should compensate home manufacturers for the rate already imposed upon the raw material imported. A protective duty is sometimes the best method for the experiment of a young and rising industry. "The nation", said List, "must sacrifice and give up a measure of material prosperity in order to gain culture, skill, and powers of united production; it must sacrifice some present advantages in order to ensure to itself future ones."¹ "A sufficient period of incubation must be allowed for in order to give capitalists confidence in the future profitableness of the business. In framing tariff lists, however, the doctrine of comparative costs, *i.e.* the relative cost of producing different goods in the home country, has to be considered, and industries have to be selected mainly on this basis."² An import duty of a protective kind usually acts as a bonus or impetus to a home industry. At first it will lead to an increase in price in the country itself, but this may in the long run lead to a lower price as the industry becomes developed. A

¹ *The National System of Political Economy*, p. 117 (Longmans, Green & Co., 1916).

² Cairnes, *Some Leading Principles of Political Economy*, part iii. ch. ii.

country may, as it is hoped in the case of India's steel production, have such special facilities in the way of raw materials as to lead to large scale production of a key industry, such production having hitherto been prevented by the lower price of the imported article. It is necessary to protect infant industries from unfair foreign competition and to keep out the dumped article. Protection, too, may result in larger economies through production on a large scale.

Public opinion deprecates any disposition on the part of a free-trade country, such as Great Britain was until 1932, to suggest to the Dominions and India, or to a great and friendly republic like the United States, what its fiscal policy should be. That is a matter of purely domestic concern. Indeed the Joint Select Committee on the Government of India Bill recommended that "nothing is more likely to endanger the good relations between India and Great Britain than a belief that India's fiscal policy is dictated from Whitehall in the interests of the trade of Great Britain. That such a belief exists at the moment there can be no doubt. That there ought to be no room for it in the future is equally clear. India's position in the Imperial Conference opened the door to negotiation between India and the rest of the Empire, but negotiation without power to legislate is likely to remain ineffective. A satisfactory solution of the question can only be guaranteed by the grant of liberty to the Government of India to devise those tariff arrangements which seem best fitted to India's needs as an integral portion of the British Empire. It cannot be guaranteed by statute without limiting the ultimate power of Parliament to control the administration of India, and without limiting the power of veto which rests in the Crown ; and neither of these limitations finds a place in any of the statutes in the British Empire. It can only, therefore, be assured by an acknowledgement of a convention. Whatever be the right fiscal policy for India, for the needs of her consumers, as well as for her manufacturers, it is quite clear that she should have the same liberty to consider her interests as Great Britain, Australia, New Zealand, Canada, and South Africa. In the opinion of the Committee, therefore, the Secretary of State should as far as possible avoid interference on this subject when the Government of India and its Legislature are in agreement, and they think that his intervention, when it does take place, should be limited

252
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to safeguarding the international obligations of the Empire or any fiscal arrangements within the Empire to which His Majesty's Government is a party."¹ This has been accepted and India is now a highly protected country. The Finance Department of the Government of India complains that many of the duties such as those on sugar are so high as to be quite incompatible with a revenue tariff. The law of diminishing returns is in operation.

THE IMPORTANCE OF CUSTOMS REVENUE

2. In the chief industrial countries the customs revenue is, with rare exceptions, of relatively less importance in the total tax revenue than before the War. This is especially so in the United States and in Australia, where the development of direct taxation

Country.	Percentage of Customs Revenue to Total Tax Revenue.	
	Pre-War (1913-14).	Post-War (1933-34).
Great Britain	21.7	25.3
India	14.7	35.1
Australia (Commonwealth) .	76.3	39.5
Canada (Dominion)	81.2	24.3
New Zealand „	57.9	30.2
S. Africa (Union) . . . . .	..	22.2 *
U.S.A. (Federal)	43.6	13.4
France	15.9	15.1
Italy	13.6	11.7
Japan	10.0	11.4

* 1932-33.

has accounted for a part of this decrease. In 1933, for example, in the United States the customs revenue was only 13 per cent of the total Federal revenue. India is one of the few countries which has considerably increased the proportion of revenue since the War, owing to a rise in duties and the spread of protection to her industries. There is also a tendency for new countries to rely on customs more than older countries. As a general rule in modern industrial countries approximately one-sixth of the total revenue

¹ Report on the Government of India Bill from the Joint Select Committee, clause 33, p. 10 (Government Printing Works, Delhi, 1919).

may be regarded as the average yield from customs revenue. The table on preceding page shows the relative importance of customs before and since the War. The greater proportion of customs duties is collected from a few articles. In Great Britain 77 per cent of the net receipts from customs in the year ending 31st March 1934 was obtained from tobacco, oil, sugar, wine, spirits, tea, matches, coffee and cocoa, and clocks and watches. Tobacco itself accounted for 38 per cent of the whole. One of the many practical results of the publication of *The Wealth of Nations* was the reduction of the number of dutiable articles by Huskisson, Peel, and Gladstone in the nineteenth century, when the revenue-yielding tariff was relieved of the incubus of a large number of taxed articles. Just over a century ago the English tariff schedules applied to some 1400 articles, which resembles the 1500 of the American tariff at the present time. In India to-day 50 per cent of the total customs is collected from four articles, and the same may be said of certain other countries, such as the Dominions.

THE FORM OF A TARIFF

3. There is next the question of *ad valorem* and specific duties. An *ad valorem* duty is a duty expressed as a percentage of the value of the imported commodity, while specific duties are duties expressed as a definite sum to be paid for a definite measure or weight of the commodity. India, Canada, the United States, and Australia have mainly *ad valorem* customs duties, although in very varying degrees. *Ad valorem* duties have been abandoned in Germany and in most other countries of commercial importance, and specific duties have generally taken their place, as the latter are comparatively easy to collect and simple from the administrative point of view. It is easy to grade the duties for slight variations in the physical nature of the commodity and thus to make for specialization, such as the number of threads per square inch in cotton manufactured imports. *Ad valorem* duties have not the same capacity in this respect. There is, moreover, no difficulty in valuation as with the *ad valorem* duty. There is little scope for fraud and evasion as is generally the case with *ad valorem* duties, the great drawback of which is that they necessitate valuation and throw a great strain on the appraising staff. Specific duties are defective in that they are regressive in

character as they constitute a heavy burden upon less valuable goods than upon the valuable goods of the same class. Thus in the case of tobacco the tax on the cheaper grades is a larger proportion of the total price than in the more expensive. They do not also respond to changes in the price level, and this is often urged against such duties. It is in practice extremely difficult to construct an ideal system of specific duties as this involves differentiation of different grades of the commodity. The *ad valorem* duty in the United States depends, as in many other countries, on the declaration to be countersigned by the Consul in the exporting country. During the War experience showed that even under efficient supervision it is not infrequently impossible to get the actual market value of the goods at the time of exportation. In India forged documents were sometimes presented. But in India the system has worked better than in most countries, since *ad valorem* values as provided for under the Sea Customs Act are based on wholesale market prices.¹ The system, nevertheless, does undoubtedly lay a considerable amount of responsibility on the customs staff, but it provides for an automatic increase in revenue with the rise in prices, just as a specific duty provides against a fall in revenue when prices fall. It is also well known that it is more desirable that revenue should increase automatically than that the Government revenue should be maintained unaltered when a fall in prices occurs. Although the tariff in India is an *ad valorem* tariff, certain articles, such as salt, kerosene oil, spirits, and matches, are subject to specific duties, while other articles, mainly sugar, metals, silk, chemicals,

¹ Sections 30 and 31 of Act VIII. of 1878, which read as follows :

" 30. For the purposes of this Act the real value shall be deemed to be—

" (a) the wholesale cash price, less trade discount, for which goods of the like kind and quality are sold, or are capable of being sold, at the time and place of importation or exportation, as the case may be, without any abatement of deduction whatever, except (in the case of goods imported) of the amount of the duties payable on the importation thereof, or

" (b) where such price is not ascertainable, the cost at which goods of the like kind and quality could be delivered at such place, without any abatement or deduction except as aforesaid.

" 31. Goods chargeable with duty upon the value thereof, but for which a specific value is not fixed by law for the purpose of levying duties thereon, shall, without unnecessary delay, be examined by an Officer of Customs. If it appears that the real value of such goods is correctly stated in the bill-of-entry or shipping-bill, the goods shall be assessed in accordance therewith."

and dyes, are assessed by means of the system known as tariff valuation, *i.e.* a combination of specific and *ad valorem* duties. The Government from time to time determine the value of the article under this tariff valuation system for purposes of assessment, and this value is then taken as the conventional value for the article in regard to the payment of customs duty throughout the period, usually a year. This tariff valuation system is equivalent to a system of specific duties adjusted from time to time to meet changes in prices, the basis being a uniform *ad valorem* rate. This system combines the advantages of specific and *ad valorem* duties. It has the advantage of specific duties in that it relieves customs officials from often a difficult valuation, as in the case of the imports of manufactured silk, which is difficult to appraise. The importer also is able to calculate ahead what he has to pay as duty. If the adjustments are made at fairly frequent intervals the fluctuations in prices do not result in a loss of duty, and the public know under this tariff valuation system the exact rate at which duty is to be levied when doing their business. If the tariff of a country is high, specific duties are on the whole preferable from the administrative point of view. In the case of a specific duty the importer knows exactly what he will have to pay as duty, as in the case of tariff valuation. Specific duties, however, being fixed, require frequent changes when prices fluctuate, and they do not give a very clear idea of the rate of duty and the actual burden except to those with expert knowledge. Specific duties require to be revised periodically. In a period of rising prices, for example, if not promptly altered, the real income of the State will, as we have seen, suffer. In those countries where high protection is intended *ad valorem* duties require the most careful watching. The Indian Fiscal Commission, for example, concluded that "while the Indian tariff must contain, as at present, *ad valorem* and specific duties and tariff valuations, the system of specific duties and tariff valuations might be extended cautiously, wherever examination by the Tariff Board shows that this is likely to be in the general interests".¹ With the increase in protectionist policy in recent years specific duties have become more popular, because a high degree of protection is less easily seen when expressed as a specific duty than when as

¹ Report of the Indian Fiscal Commission, p. 150 (Simla, Superintendent, Government Central Press, 1922).

an *ad valorem* duty. A heavy import duty on sugar, for example, when expressed at so much per cwt. does not appear so great as when expressed in a form of a high percentage. Again, protectionists prefer specific duties because when prices are falling (and in consequence the need of protection is more keenly felt) an unchanged specific duty gives an increasing rate of protection. Lastly, when the price of the protected article is subject to very considerable changes an *ad valorem* duty gives the least protection when prices are low and protection is therefore most required, just as it gives the greatest protection when prices are high and protection is least needed. In short, the advantage of an *ad valorem* duty varies inversely as the need for such benefit. Some articles lend themselves to one type of duty and some to the other type. Standardized articles such as wheat, sugar, and pig-iron lend themselves to specific duties, while other articles possessing a large range of qualities and values such as textiles lend themselves, on the whole, to *ad valorem* duties.

MISCELLANEOUS FUNCTIONS

4. The duties of the customs authorities are not confined to *ad valorem* and specific duties. They have to prevent the importation of certain articles. In Great Britain, for example, obscene literature, advertisements of lotteries, foreign gold and silver plate without assay, foreign reprints of copyright works, the plumage of birds (with certain exceptions), shaving brushes manufactured in or exported from Japan, and prepared opium are not allowed to be imported. In addition to the prevention of importation the customs authorities have to prevent the irregular importation or irregular exportation of certain goods. In Great Britain, explosives, synthetic organic dyestuffs, hops, arms and ammunition, dangerous drugs, and goods coming within the Anthrax Prevention Act are imported under certain regulations, and this requires careful scrutiny. Arms and ammunition, dangerous drugs, gold and silver coins, and gold bullion are similarly allowed to be exported under certain conditions only. The customs authorities, however, have other duties to perform, such as the preparation of statistics. In the United Kingdom the Customs and Excise Departments now form one Department, and these authorities undertake the collection, in certain cases,

of income tax and the sale of stamps, the collection of agricultural statistics, the enforcement of certain health regulations, the detention of vessels and cargoes, the enrolment and payment of men for the Royal Naval Reserve, the investigation of claims to exemption from National Health Insurance, the collection of passenger returns under the Aliens Acts, the collection of the transferred taxes, and the administration of the Old Age Pensions Acts on behalf of the Government of Northern Ireland by virtue of an agency agreement under the Government of Ireland Act, 1920.

CUSTOMS DUTIES IN ENGLAND

5. It will now be convenient to review briefly some of the main features in the history of customs duties in the British Empire, in one or two continental countries, in the United States, and Japan. We are in search of principles rather than of detailed facts.¹

In Great Britain the history of customs is of great interest. It is possible to trace the history from the time when export duties on wool and import duties on wine were levied. In 1490 a retaliatory duty on malmsey wine from Crete was imposed as a counterblast to the heavy import duties levied by the Venetians until the latter should abate their new impositions. Up to the year 1700 customs duties were for revenue purposes and were approximately 5 per cent on imports and exports. The tariff, speaking generally, was arranged to yield the required revenue with the least possible effect on the trade of the country. The period 1700 to 1825 was a period of high protection, except during the peace years when Walpole was in power. This latter period extends from 1721 to 1742. It is said of Walpole that he found the tariff the worst in the world and left it the best. The exigencies of the State were so great in the eighteenth century that a 25 per cent duty was in vogue as early as 1759, and other articles, such as tea, coffee, sugar, tobacco, salt, wines, and spirits, paid much higher rates. Heavy duties were placed upon the importation of raw silk in 1765, and this continued for sixty years.

¹ Reference should be made to *History of Taxation and Taxes in England*, Stephen Dowell (Longmans, Green & Co., 1884), if a detailed history of the English system is desired.

From 1802 onwards import duties on wool were greatly increased and rose eleven-fold between 1802 and 1819. An import duty on tea was first levied in 1689 at 5s. per lb. The rate was so excessive that smuggling continued until Walpole, in 1723, introduced a warehousing system similar to that for pepper. On importation an *ad valorem* duty of 14 per cent was levied, and when removed from the warehouse a further (inland) duty of 4s. per lb. for home consumption was imposed. Later the duty was increased, and Pitt in 1784 reduced the tax from 119 per cent to 12½ per cent; in 1795 this was raised to 20 per cent, and in 1801 to 50 per cent, and in 1819 to between 96 and 100 per cent. In 1836 the rate was 2s. 1d. per lb., and Gladstone reduced it. From 1857 to 1863 it was 1s. 5d., and from April 25, 1863, 1s. In recent years the taxation of tea has been reduced but in 1936 was increased by 2d. per lb. British Empire tea now is taxed at 4d. per lb. and foreign tea at 6d. per lb. The consumption of tea per head, in the United Kingdom of Great Britain and Northern Ireland, is a shade over 10 lbs. per annum.

From 1825 commenced the period which is noteworthy for the large reduction in the number of articles on the tariff lists and for the policy of free trade. In 1660, 1630 articles were subject to duty; in 1781, 1425; in 1826, 1280; in 1841, 1052; in 1845, 1163; in 1849, 515; in 1853, 466; in 1859, 419; in 1876, 42; and in 1924 only 25,¹ excluding key industry goods. With the passing of laissez-faire and the growth in protection in recent years, especially since the Import Duties Act, 1932, the number of articles in the tariff schedules has considerably increased.

The reforms of Huskisson and Robinson in 1824 necessitated a further instalment of the reforms which Gladstone completed when Chancellor of the Exchequer. The duty on the import of foreign wool was reduced to one penny to suit manufacturers, while exporters were given the right to export on the payment of the same charge. The prohibition on the export of wool was thus removed, and foreign wool was admitted on the same conditions as home wool was exported. The protection given to the silk industry was modified by the reduction of the import duty on the raw material, and the prohibition on the import of manufactured goods was not removed until July 1826 in order that manufacturers might have an opportunity of preparing for

¹ *Vide* Fourteenth Report, Customs and Excise, Cmd. 1933, 1924.

competition. In 1825 the reforms of the previous year, instead of producing a loss of revenue, produced a surplus. The high duty which prohibited the import of bar iron was reduced, and similarly the high duties on home coffee, cocoa, and wines were curtailed. Although Great Britain had no serious rival, cotton manufactures were actually protected by import duties ranging from 50 to 75 per cent. This was reduced to a uniform duty of 10 per cent on all cotton manufactured goods. In no case was a higher protective duty to be given than 30 per cent. A distinguished Civil servant, James Deacon Hume (1774–1842), codified, as a result of these changes, the various customs laws in force, and on 5th July 1825 a Consolidating Act (6 Geo. IV. c. 105) was passed. In this act 443 statutes were enumerated, and the remaining acts were repealed by a general definition. The laws accumulated during the previous 550 years were done away with. In June 1815, it may be remembered, 1100 customs acts were in force.

Peel in 1841 was convinced that the recovery of industry was partly delayed by the lack of a simple tariff. Complicated duties, in his opinion, strangled trade, and he felt that a movement in a free trade direction was necessary owing to the circumstances at the time. The Report of the Committee on Import Duties appointed in 1840 recommended that duties should be charged on a small number of commodities in order to "facilitate the transactions of commerce, benefit the revenue, diminish the cost of collection, and remove the multitudinous sources of complaint and vexation". The principles on which the new tariff of 1841 was constructed were : (1) the removal of prohibitory duties or their reduction ; (2) the reduction of duties on raw materials, not exceeding 5 per cent *ad valorem* ; (3) the reduction of the duty on partially manufactured articles to a rate not exceeding 12 per cent *ad valorem* ; and (4) the reduction of duties on manufactured articles to a rate not exceeding 20 per cent *ad valorem*. The revision necessitated changes in 750 out of a total of 1200 articles on which duties were paid. The tariff was further revised in 1845 and in 1856. The abolition of import duties on wheat (the Corn Laws) took place in 1846. The opposition to the repeal of the Corn Laws was mainly from the landed classes, whose power was immense for centuries before the introduction of the first Reform Bill. Gladstone completed the work which Peel had

undertaken as Chancellor of the Exchequer in 1853, and removed completely in 1860 the protective features of the tariff.

The growth of the British customs revenue may be gauged from the following table :

BRITISH CUSTOMS REVENUE

	£ (Millions).	Year ended 31st March	£ (Millions)
1688	1	1919	103
1714	1.6	1920	149
1785	4.5	1921	134
1802	9.9	1922	130
1817	11.9	1923	123*
1842	23.5	1929	119
1847	22.2	1930	123
1854	22.5	1931	121
1874	20.3	1932	136
1886	19.8	1933	167
1903	34.6	1934	180
1914	35.5	1935	185

* Great Britain and Northern Ireland since 1923.

With the passing of laissez-faire after the Great War the general argument for industrial liberty has greatly lost its force. From the point of abstract theory protection within certain limits and in certain cases is advantageous to the world as well as to the protecting country, but unfortunately these qualifications are never adhered to. Owing to the resurgence of economic nationalism, and to political and other reasons, it is impossible to expect governments to keep protection within ideal limits, and each State to-day seeks protection for its industries and is making customs duties as a revenue source of secondary importance. Every important country now protects its employment and markets. It was only in 1932, as we have seen, that England found it necessary to turn to protective tariffs. She had already some experience of this from the safeguarding duties as fixed by the Safeguarding of Industries Act, 1921, and the Safeguarding of Industries (Customs Duties) Act, 1925. These Safeguarding Duties made it possible to levy a duty at the rate of one-third of the value of the goods imported, which are classified as "key" industry goods. But goods produced and manufactured in the British Empire were exempt from duty. By the Safeguarding of Industries Act it was also provided that a similar rate of duty was leviable on the importation of goods

from countries with a depreciating currency. The tariff weapon is now used for bargaining with other countries. Bitter experience had taught Great Britain that other countries would not remove the restrictions on European trade. Indeed these restrictions had grown and the sale of surplus foreign products was steadily growing in the British market. The Abnormal Importations Act, 1931, was passed to counteract this, and in the following year this was followed by the Import Duties Act, 1932. *Ad valorem* duties were imposed on all imports, with certain exceptions. The justification was, of course, revenue and the saving of the pound, but behind this was the necessity of following the policy of protection adopted by all competitors. The policy of protection was followed by the Ottawa Conference, as a result of which preferential customs rates were adopted by Great Britain and other members of the British Empire. The Ottawa Agreements Act was passed in 1932. In order to minimise the danger of undue use of political influence by industrial interests and the possibility of the tariff becoming an instrument for the protection of inefficiency and backwardness rather than an impartial tariff, a Committee known as the Import Duties Advisory Committee, consisting of a chairman and not less than two or more than five members, was created by the British Parliament under the Imports Duties Act of 1932. Similarly in India, the Tariff Board examines carefully every case for protection and makes recommendations to the Government of India. Under the Import Duties Act, 1932, duties are imposed on *all* articles imported into the United Kingdom, with certain exemptions, and certain articles have to bear a high duty for protective reasons. The act was passed "with a view to the restricting in the national interest of the importation of goods into the United Kingdom, to the providing of a remedy in cases where a foreign country discriminates in the matter of importation as against goods produced or manufactured in the United Kingdom . . . and to the making of an addition to the public revenue". It provided for a general *ad valorem* customs duty of 10 per cent, except in the case of (1) goods already dutiable ; (2) goods specified in Schedule I of the Act or to be specified in subsequent orders ; (3) goods consigned from any part of the British Empire within specified periods ; and (4) goods from other countries to be specified. Nevertheless, as has already been noted, the list of important revenue producers is comparatively small, as will be

seen from the following table, which gives in rounded figures the net receipts from customs :

							Customs Receipts, 1933-34 £ (Millions)
1. Tobacco							67·6
2. Oil							39·9
3. Sugar							10·2
4. Beer							5·0
5. Spirits							4·4
6. Wine							4·1
7. Tea							3·7
8. Matches							1·9
9. Coffee and Cocoa							0·9
10. Clocks and Watches							0·5
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	Total						138·2
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<i>Grand Total of net receipts from customs, including the 10 classes above</i>							180
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THE DOMINIONS

6. In the self-governing Dominions and India protection is the order of the day. The percentage *ad valorem* rate of duty on dutiable imports in Canada in 1926 was 24·7 per cent and 15·5 per cent on the total imports from all countries. The following table is of interest in this connection :

DUTIABLE IMPORTS—AVERAGE <i>AD VALOREM</i> RATE OF DUTY				
				1926.
From Great Britain				21·6 per cent.
From United States				23·9 , ,
From all countries				24·7 , ,

The revenue from customs was \$127 million in 1926 out of a total revenue of \$383 million. Canada adopted a protective tariff in the fifties of the last century. In 1859 Sir A. T. Galt, Minister of Finance, prepared a report emphasising the right of the Canadian Parliament to levy taxation,¹ as it deemed best, even though it may run counter to the wishes of the British Ministry. This doctrine was not challenged by the British Government. The

¹ The great part of taxation was then raised through customs duties.

confederation of provinces, in 1867, led to the removal of the internal tariff barriers throughout Canada. There was a uniform tariff against all countries until 1897, when preference was granted to British goods by the remission of a percentage of the duty imposed. This method of preference was given up in 1904, and a specially low rate of duty on almost all dutiable commodities was adopted. A new tariff was introduced in 1907 which is the basis of the present tariff. The rates were in many cases raised to produce more revenue during the years of the recent great depression. At present there are three different tariffs—general, preferential, and reciprocal. The general tariff applies to all countries except those that come under the second and third. The preferential tariff applies to the British Empire, while the reciprocal or intermediate tariff applies to countries such as the United States, with which special commercial treaties have been made. Special commercial treaties have been concluded with France, her colonies and protectorates, Belgium, Italy, and the Netherlands. The countries that are included under the reciprocal most-favoured-nation clause are the Argentine Republic, Colombia, Denmark, Japan, Norway, Russia, Spain, Sweden, Switzerland, and Venezuela. The Canadian customs tariff contains an anti-dumping clause. Drawbacks of 99 per cent of duties are also permitted on the raw materials imported when they are exported as manufactured articles. Since 1903 a surtax has been imposed on imports from those countries which treat Canadian imports less favourably than those from other countries. The surtax can be applied even to goods on the free list. No duties have been collected on exports since 1892, except in regard to the export of fur from the North-West Territories, placer gold from the Yukon Territory, and on the export of electrical energy. During the War special duties were levied. In August 1914 the duties on coffee, sugar, spirituous liquors, and tobacco were increased. In 1915 *additional* duties of 5 per cent *ad valorem* under the British Preferential Tariff and $7\frac{1}{2}$ per cent *ad valorem* under the Intermediate and General Tariffs were imposed, but certain articles were exempted from these increases. In 1918 the duties on tea, coffee, and tobacco were increased. In 1919 the 5 per cent increase in the British Preferential Tariff was abolished and the $7\frac{1}{2}$ per cent increase in the Intermediate and General Tariffs was partially repealed. There were also other reductions

in the rates of duty on certain articles, especially agricultural implements. Specific in place of *ad valorem* duties were imposed in 1919 on pig-lead, zinc spelter, and copper ingots. The Department of Customs and the Department of Inland Revenue were amalgamated in 1918 into one Department—the Department of Customs and Inland Revenue, under one Minister of the Crown.

In Australia, under the tariff of 1921, about 46 per cent of the imports are subject to *ad valorem* rates, 25 per cent to specific duties, and the balance of about 29 per cent are free of duty. A comparison of the tariff now in force with that before the War shows that the proportion of dutiable goods has increased from 57 per cent to 64 per cent. The average *ad valorem* rate of duty on dutiable goods has increased from 29·96 per cent to 31·93 per cent. The average percentage duty on all merchandise increased in the same period from 17·08 per cent to 22·63 per cent. The equivalent *ad valorem* rates of duty under the tariff of 1921 was 107 per cent on spirits, 85 per cent on tobacco, 53 per cent on ores, 41 per cent on jewellery and fancy goods, 35 per cent on rubber goods, 21 per cent on iron and steel, and 27 per cent on other manufactures of metals. The duty on apparel is 37 per cent, on leather 32 per cent, on textiles 22 per cent, and on miscellaneous goods 31 per cent.

Before the establishment of the Commonwealth in Australia each state had its own tariff and the inter-state trade was previous to this similar to overseas trade. From 16th September 1902 trade between the different states of the Commonwealth became free. Western Australia, however, reserved the right to levy duty on the goods of other states up to 1907. The present Tariff Schedule provides a Preferential Tariff, an Intermediate Tariff, and a General Tariff. The first is applied to the British Dominions and the second to the British Dominions or to any foreign country. The General Tariff is in force against countries other than those coming under the British Preferential and Intermediate Tariffs. The Commonwealth Tariff Act of 1908 provided preferential rates for certain goods produced in the United Kingdom. The list of articles has been enlarged and the margin in favour of the United Kingdom extended. To be eligible for preferential treatment goods must be wholly produced or manufactured in the United Kingdom. In the case of goods not wholly produced or manufactured, at least three-fourths of the value should be repre-

sented by British labour or material. However, one-fourth of the value represented by British labour or material will be enough for those goods which are not commercially manufactured in Australia. It is, however, necessary that in each case final processes of manufacture should have been carried out in the United Kingdom. The goods must be consigned therefrom direct to Australia. This was the position prior to the Ottawa Conference. In 1926 ninety-five per cent of British merchandise was preferentially treated, and the average margin of preference, viz. 12·91 per cent *ad valorem*, represented a loss of duty of £7,981,000. Preference to South African goods has been extended since 1906. From 1st September 1922 a preferential tariff was extended to New Zealand. Reciprocal tariff arrangements between Canada and Australia have been made as a result of the Ottawa Conference. Since 1921 a Tariff Board of three members has been set up to whom the Minister refers for report questions relating to the classification of goods for duty, the determination of the value of goods, the necessity for new, increased, or reduced duties, the necessity for granting bonuses, the application of the different tariffs to the different countries, and complaints relating to the undue advantages taken by manufacturers by charging unnecessarily high prices. Provision is made for levying anti-dumping and depreciated currency duties. The revenue from customs amounted to £22 millions out of a total Commonwealth revenue of £56 millions in 1933-34.

In New Zealand a tariff of definitely protective intention dates from 1895. There is a General Tariff, an Intermediate Tariff, and a Special Tariff for British Empire goods. Most of the duties are specified, but on some articles an *ad valorem* duty from 5 per cent upwards is levied under the Customs Amendment Act of 1921. A rate of duty is fixed in the case of countries with a depreciated exchange, and by the Customs Amendment Act, 1921, provision is made for a special dumping duty which may be imposed by the Minister of Customs on goods imported if the selling price to an importer is less than the current value of the goods, and provided that such imports are likely to have a prejudicial effect on an industry established in the Dominion. In such a case the special duty shall not exceed the difference between the actual selling price and the current domestic value. As in the case of Australia changes have been

made as a result of the Ottawa Conference. The only export duties in force are those on the export of timber under the Timber Export Act, 1908, and on gold under the Gold Duty Act, 1908, and the Amendments Acts. Out of a total tax revenue of £21,486,000 for the year ending 31st March 1934, customs duties accounted for £6,485,000.

Section 136 of the South Africa Act of 1909 has declared free trade within the Union.¹ The customs tariff is protective, and in certain cases prohibition of imports is possible. The *ad valorem* duties ordinarily vary from 3 to 25 per cent. Specific duties are also levied, especially on foodstuffs, drink, and tobacco. Duties from apparel, textiles, liquors, and metals including iron and steel, are the main sources of revenue. Customs revenue is the principal head of the Union Government's revenue. For the year ending 1933-34 customs revenue amounted to £7,981,000 as compared with £7,490,000 from income tax out of a total revenue of £35,978,000. The most important point regarding customs duties in South Africa is the preference accorded to goods the produce of reciprocating countries within the British Empire. As far back as 1821, the Cape Province taxed British goods at 3 per cent and other goods at 10 per cent. A rebate of 25 per cent of the *ad valorem* duties was provided for on imports from the British Empire, which granted reciprocal privileges. By the Tariff Act of 1914 it was provided that imports from Great Britain and the reciprocating Dominions of Australia, Canada, and New Zealand should pay 3 per cent less than other countries in respect of the goods chargeable with *ad valorem* duties. Rebates were also allowed on imports subject to special duties. The percentage of the rebates was approximately 12 per cent of the customs revenue. The system of Imperial preferences had been revised even previous to the Ottawa Conference, preferential treatment being given in the form of minimum duties on specific articles selected with due consideration. Proper attention is given to the needs of the Treasury as well as to industries of the Union and to the export trade of Great Britain and the Dominions. Other countries were to pay the maximum duties. Minimum duties also were applicable to other countries for reciprocal privileges, but in that case lower duties were also to be applied to Great Britain. In 1926

¹ For the previous history of the customs in South Africa vide *Protection in South Africa*, by A. J. Bruwer, Stellenbosch (Pro-Ecclesia Printing Works, 1923).

protective duties were levied on wheat, whisky, brandy, enamelled sheets, and girders, on the recommendation of the Board of Trade and Industries. Articles required for industrial purposes, including agricultural machinery, are imported free of duty. The tariff, however, is defective in that it contains a number of *ad valorem* duties on household and other articles not produced or manufactured in the Union.

INDIA

7. The history of Indian customs duties is particularly instructive. It divides itself into four main periods : (i.) up to the year 1861 ; (ii.) the free trade period, 1862 to the beginning of the War (1915) ; (iii.) the War and post-Armistice period (1916–21) ; and (iv.) the period beginning 1922, the year in which the Indian Fiscal Commission reported. As a result of this Commission (i.) a policy of protection was advocated with discrimination "so as to make the inevitable burden on the community as light as is consistent with the due development of industries and to avoid abrupt disturbances of industrial and commercial conditions",¹ and (ii.) a Tariff Board was set up.

Firstly as to period one. During the Moghul period customs duties were low. At Surat, for example, in 1609, they were 3 per cent on provisions, 2 per cent on gold and silver coined or uncoined, and $2\frac{1}{2}$ per cent on other goods. Delay, over-valuation, and compulsory sales by the customs authorities were not unusual. In the time of the Moghuls the rate may be said to have approximated to 5 per cent *ad valorem*, although it was less in some places. There was also a system of internal land customs or transit duties, a system that was not done away with by the East India Company until 1844. In the forties of the last century there was a tariff of $3\frac{1}{2}$ per cent on raw materials and from $3\frac{1}{2}$ to 5 per cent on manufactured goods. If, however, the goods were carried in non-British bottoms these rates were 7 and 7 to 10 per cent respectively. From 1848 to 1859 differential duties on the basis of the origin of the goods were imposed in place of the nationality of the shipping, the duty on British goods being one half of those on non-British goods. There was also a duty on

¹ Page 51, *Report of the Indian Fiscal Commission* (Simla, Superintendent, Government Central Press, 1922).

most exports of 3 per cent *ad valorem* or a rate approximating to that figure. In order to balance the Budget the Right Hon. James Wilson increased in 1859 the general rate of duty from 5 to 10 per cent and certain luxuries had to pay 20 per cent. The luxury rate of duty lasted only for a year, as it was not productive. The duty on cotton yarn was raised in 1859 to 5 per cent from $3\frac{1}{2}$ per cent. Although export duties were levied at the rate of 2 annas per maund on grain, Rs.3 per maund on indigo, 4 per cent *ad valorem* on lac, and 3 per cent on most other articles, the Finance Minister exempted (in 1859) raw cotton, raw silk, sugar, and tobacco. Tea, coffee, wool, jute, raw hides and skins were freed from export duties in the following year. Saltpetre, however, had to bear a heavy export duty. These duties were for revenue purposes.

The free trade period from 1862 to 1915 may be conveniently divided into two periods, (a) 1862–1894 and (b) 1894–1915. The influence of the gospel of free trade had spread to India, as it had to the Dominions and the United States. The period from 1862 to 1894 is marked by a reduction and then by a general abolition of duties. Under financial necessity, Sir James Westland, Finance Minister, had in 1894 to reimpose duties, and in some cases to increase the few duties then in force, and this year marks the beginning in an upward direction of our revenue tariff.

In 1862 the duty on imported cotton piece-goods was reduced to 5 per cent, and on imported cotton yarn to $3\frac{1}{2}$ per cent. Two years later the general tariff was reduced from 10 to $7\frac{1}{2}$ per cent, and many articles were freed from duty. In 1867 the export duty tariff list was reduced from 97 articles to 9, and saltpetre was one of the articles on which an export duty was abolished. In 1873 wheat was no longer required to pay an export duty, and in 1875 the list was reduced to three articles—indigo, lac, and rice. In the same year (1875) the general rate of import duties was reduced from $7\frac{1}{2}$ to 5 per cent, the duties of 5 per cent on cotton piece-goods and of $3\frac{1}{2}$ per cent on cotton yarn remaining the same. The British Government directed the Government of India to abolish these cotton duties as soon as it was financially possible, and here we already have, in the words of the Fiscal Commission, “the ill-omened shadow” of the cotton duties controversy on the tariff policy of this

country. In 1878 the cotton duties were partially abolished, and in 1880 indigo and lac were removed from the export tariff list, rice alone remaining. In 1882 the general customs duty on imports and the remaining duties on cotton were removed, and only rice remained on the export list. Between 1882 and 1894 the only duties retained were those on arms, ammunition, liquors, opium, and salt, and from 1888 the half-anna per gallon duty on petroleum. The duty on arms and ammunition was kept for administrative reasons, while that on liquors, opium, and salt was complementary to the excise duty on these articles.

A general import duty of 5 per cent was levied in 1894. At first cotton goods were imported free, but later on in the year an import duty of 5 per cent was necessary on both piece-goods and yarn, and a countervailing duty of 5 per cent on Indian yarn of counts above 20's was also levied. Railway materials and machinery were placed on the free list, and a duty of 1 per cent was imposed on iron and steel. In 1896 the duty on cotton piece-goods was reduced as was the countervailing duty on Indian-made piece-goods to $3\frac{1}{2}$ per cent, cotton yarn being freed from the payment of customs or countervailing duty. From 1897 to 1910 the tariff remained practically the same as it was in 1896. In 1910-11 the import duty on liquors, tobacco, silver, and petroleum was increased. In 1902 the question of Imperial Preference was examined, but, as the Finance Minister (Sir Edward F. G. Law) phrased it, "in existing circumstances and in view of the fact that our exports consist almost entirely of raw materials and produce, it does not appear probable that materially important advantages could be offered to us under a system of preferential tariffs in our favour adapted for other parts of the Empire". The Fiscal Commission recommended that no preference should be given if it diminish the protection required by Indian industries. Such preference should not lead to any net appreciable loss to India, and it should not be granted without the consent of the Indian Legislature.

The third period—the War and post-Armistice period—shows clearly the effects of the War. The necessity for more revenue led to an increase in the general import tariff to $7\frac{1}{2}$ per cent in 1916 and to 11 per cent in 1921. In the former

year the free list was reduced, $2\frac{1}{2}$ per cent was imposed on railway material and machinery other than that for cotton mills, and 10 per cent on sugar. The duty on iron and steel was raised from 1 to $2\frac{1}{2}$ per cent, and the duties on liquors and tobacco were also increased. In 1917 the import duty on piece-goods was raised to $7\frac{1}{2}$ per cent, the countervailing duty on Indian-made goods remaining at $3\frac{1}{2}$ per cent. In 1921 cotton-mill machinery and stores were removed from the free list and a specific duty was placed on matches. Luxury articles, such as motor cars and watches, were taxed at 20 per cent. Export duties on raw and manufactured jute and on tea were imposed in 1916, and in the following year the jute export duty was doubled. In 1919 a protective export duty on raw hides and skins was imposed to protect the Indian tanning trade, and $66\frac{2}{3}$ per cent rebate was granted if exported to the British Empire for tanning.

The fourth period, beginning with 1922, saw a rise in the general import tariff to 15 per cent. This tariff is now 25 per cent *ad valorem* and is definitely protectionist, as will be seen from a study of the Tariff Schedules. In regard to articles which are exceptions to the general rate, cotton piece-goods pay 50 per cent, unless of British manufacture, when they pay 25 per cent. Silk or artificial silk mixtures pay 35 per cent or 2 As. 3 pies per square yard, whichever is higher. Motor cars and motor cycles $37\frac{1}{2}$ per cent. Sugar pays the high rate of Rs.9 As.1 per cwt. "Luxury articles" pay 50 per cent, cigars $112\frac{1}{2}$ per cent, cigarettes 25 per cent *ad valorem* plus either Rs.8 As.2 per 1000 or Rs.3 As.4 per lb., whichever is higher; spirits generally pay Rs.37 As.8 per gallon, and perfumes Rs.60 per gallon. Certain metals and railway plant pay a lower rate and agricultural implements and quinine are free. There are also protective duties at special rates on special articles such as iron and steel and certain manufactures thereof. The two outstanding facts in the recent history of Indian tariff legislation are (1) the strong movement towards high protective tariffs, oblivious of the possible results on the consumer, predominately an agricultural consumer, and (2) the acceptance of the principles of the Ottawa Conference in regard to preferential tariffs within the Empire but not at the expense of India herself. Finance Ministers in recent years have pointed out that the tariff originally designed for revenue is becoming, on account of its recent pro-

tectionist character, less productive of revenue than it should be. It is for this reason that excises on sugar and matches have been introduced. The prosperity of the cotton textile industry relatively to that in most other countries of the world, Japan perhaps excepted, is largely owing to high protective tariffs. Customs revenue in 1933-34 was no less than Rs.4855.2 lakhs out of a total Central tax revenue of Rs.7984.3 lakhs.¹

The customs duties that obtain in other parts of the British Empire do not require separate examination. In many colonies export duties are in force, as in the Federated Malay States, which produce rubber and tin, and the West Indies, which produce sugar. The time is coming when Crown Colonies will have to spend money on the development of social services, such as education, sanitation, and medical relief, which will be a sound investment in the long run. The overhauling and perfecting of the customs system are in some of these already overdue.

OTHER COUNTRIES

8. It will not be possible to review the history of tariffs in free-trade countries like Holland, Denmark, Norway, Switzerland, and Belgium, for reasons of space. The case of Great Britain has already been dealt with in some detail. It will also be impossible to review in detail the protective principles underlying the customs duties of France, Germany, Italy, the United States, and Japan. Protection as a national policy is evident in the history of France, as in the majority of countries. The revenue from customs for the year ending December 1934 was 5.3 milliard frs. out of a total national tax revenue of 35.1 or a total national, provincial, and local tax revenue of 48.7 milliards. Customs duties from sugar and salt are taxed through the customs and the excise, as are petrol, benzol, and one or two other products. Food and raw materials are subject to duty as well as manufactured goods. The same applied to Germany before the War. The French tariff is built upon the system introduced in 1791, together with a conventional tariff system based upon treaties. The reforms introduced by the law of 1892 fixed a maximum or general tariff extending to seven hundred items, and a minimum tariff, which allowed the import at special rates of goods of countries

¹ Rs.1 lakh = Rs.100,000 = £7500.

which gave similar concessions to French goods. Nevertheless, as one's eye goes down these tariff lists one is struck by the number of unproductive duties, and in this the French customs is in strong contrast with the British system. The duties on food-grains, like those in Germany and Italy, fell on the working classes, and it is doubtful whether the protective nature of the tax outweighs its drawbacks. France is much in need of a second Colbert to systematise (as the great Colbert did in 1664) the tariff with its long list of duty-paying commodities.

The tariffs of the United States¹ and Japan are of importance. The early tariff history of the United States before the War of Independence shows a somewhat selfish policy on the part of Great Britain. Certain important articles could be exported only to Great Britain, and imports were possible only in British ships. That was, indeed, part of the colonial policy of the time. The duties on imports of 1773 were on rum and sugar from countries outside the British Empire. Even before 1816, when a definite protective policy took shape, there were attempts to protect young industries. But from the date of the Constitution (1787) to the end of the war of 1812 the tariff was intended for revenue purposes. Textiles, mainly cotton and wool, and iron, however, were protected commodities. Tea, coffee, liquor, and tobacco were those which were looked to as the main sources of revenue. From the second decade of the nineteenth century the idea of protection grew, except for a possible set-back for fourteen years from 1846. The tariff of 1846, however, protected woollen and cotton goods to the extent of 20 per cent and iron 30 per cent. The Morrill tariff of 1861 increased the protective duties and introduced compensatory duties, so that if the raw material was taxed a corresponding duty was also added to the imported manufactured article to protect the home manufacturer. The tariff of 1864 placed on imports an average of 50 per cent, and in some ways was the high-water mark of protection. Possibly the Civil War compelled Congress to squeeze the utmost from its tariff. In 1890 the McKinley tariff reduced the duties on certain goods of industries which no longer required protection; but it increased the duties on other goods. Duties of a purely revenue nature were decreased. The Wilson Law of 1894 reduced the protective duties of the previous law of 1890. The Dingley

¹ Cf. Taussig, *Tariff History of the United States*.

tariff of 1897 replaced the protective duties of the McKinley tariff, and the general rate of duties was increased. Textiles, iron, hides, leather, and sugar were protected. The Payne tariff of 1909 changed some of the rates in a downward direction, but its interest lies in the fact that it provided for a minimum rate plus additions by way of retaliation in the case of those countries whose tariffs were considered to be unfavourable to the United States. In 1922 the Fordney tariff of the Republican party became law, and went further in the direction of a high protective tariff.

The United States, with a vast expanse of territory and a large population, which, however, is still only a small part of what the country could support, is more self-contained than most countries of the world. It, therefore, can view without much anxiety the very high duties of the Fordney tariff. This great economic experiment may be due to the haunting fear that the impoverishment of the chief industrial countries in Europe as a result of the War may be reflected in a lower standard of living in the United States if the products of cheap labour abroad were permitted to compete in the American market. The result of this tariff made it more difficult than ever to purchase her exports, as the country accepts neither goods nor services, and gold she already has in too great a measure. The restriction of imports to the extent that the Fordney tariff has made depressed the prices obtainable for American products abroad through the scarcity of credits in the United States to pay for them. The difficulty for other nations to purchase American products may give rise to alternate sources of supply. The creditor position of America, already a matter of embarrassment, has been accentuated by this prohibitive tariff. America, a creditor country, is refusing on the one hand to take payment from her debtors in goods or services—her high import tariff prohibits the import of goods—and on the other hand she refuses to lend abroad. Her difficulties during the greatest known economic blizzard, during the years 1929–35, are too well known to demand here a critical examination of the problem. An analysis of the United States customs revenue clearly shows that the system has been devised primarily for protection and not for revenue only. Two articles, sugar and tobacco, may be said to belong to the class of articles on which customs duties for revenue purposes should be imposed.

The remaining articles are chiefly necessary articles—food and raw materials for industry which compete with her home-produced goods and not articles in any sense of a semi-luxury nature. Nevertheless, it is interesting to note that although the customs revenue has sunk from a percentage of the total revenue in 1791–94 of 93, in 1870–74 of 54, and at the beginning of the century of 45 per cent to approximately 14 per cent at the present time, it is approximately the same percentage as that from customs in Great Britain. The tariffs of the two countries, however, differ much in structure—the former is definitely protective and covers a wide range of goods in the detailed tariff schedules, the latter a tariff built up on revenue principles to which has in the post-War years been added a protection bias.

The Japanese tariff has many points of resemblance to the Payne tariff just mentioned as well as to the French tariff of 1892. There is a general tariff and also a special tariff combined in the Import Tariff Revision Law of 1910, the basis of the present tariff. Custom-houses were set up in 1859, and the tariff revised in 1866. The tariff was not again revised until 1899, when a general tariff and a special tariff for countries with which tariff conventions had been concluded was laid down. A surtax was necessary on account of the war with Russia in 1904. In 1906 the tariff was again revised. The present tariff really dates from July 1911, being based on the Import Tariff Revision Law (No. 54) of 1910. At present there are 672 articles on the list, and specific duties are in the main collected on these. The rates on manufactured goods are 40 per cent and on some articles of luxury 50 per cent. For some manufactured goods the rates are below these, varying from 15 to 40 per cent; raw materials are mainly free, while partially manufactured goods are not assessed to heavy duties. Export duties were abolished from the beginning of the present century. Since August 1920 the tariff in force in Japan has also been applied to Korea, and with Manchukuo Japan is making special arrangements to further her interests in this direction. The conventions concluded with Great Britain, France, and Italy give special concessions of a reciprocal nature. Thus the convention concluded with Great Britain guarantees that ten principal articles of export from Japan should be exempted from customs duties when imported into Great Britain, and concessions are made in the case of certain British imports into

Japan, viz. paints, linen yarns, cotton and woollen goods, and iron sheets. The French minimum tariff rates are applied to certain Japanese products, and in return sardines in oil, butter, wines, olive oil, perfumes, woollen yarn and goods, binoculars, motor cars, and knitting machines are imported into Japan at reduced rates. Japan, like Great Britain, depends for its food-supply on foreign countries, and it builds up a large export trade for this purpose. It cannot live unto itself in the economic sense. It has an oriental birth-rate of 33 per thousand but an occidental death-rate of 17 per thousand, and is increasing at the rate of a million persons per annum. Japan is unable to emigrate in large numbers. Her only means for sustaining this large increasing population is by an industrial policy which, owing to the low costs of production obtaining in her industries, has been successful. It is, however, a policy which has led to tariffs and quotas on the part of those countries to which Japan has sent her chief products. In fact, exports and imports may be said to represent the diastole and systole of the commercial heart of Japan.

CONCLUSION

9. This survey brings out one or two facts which require additional emphasis. Customs as a source of revenue in modern industrial states has, as has already been shown, generally decreased relatively in importance and at a much greater rate in the older industrial countries than in the younger. Nevertheless in one or two countries this source of revenue is of great importance to the national Government. The imposition of customs duties is twofold—for purposes of revenue or for the protection of home industries, and these two ideas are in conflict. A highly protective tariff cannot be looked to as a bountiful source of revenue. It is not always an issue of excluding imports altogether for protective reasons and getting little or no revenue. The issue is far less clear cut. In practice the statesman has to balance the merits of a protective duty as a revenue yielder and the merits or demerits of the duty in keeping out the foreign producer. He has to consider the nature of the imports from abroad—whether they are food and raw materials, imports which are of a highly inelastic nature, particularly when the population is non-agricultural, or whether they are manufactured goods in com-

petition with national industry. He has also to consider the elasticity of demand for his country's exports abroad and whether the foreign customer is bound to purchase goods or whether other sources of supply are available to him. It is for this reason that the British position of taxing the foreigner is much less strong than it was about a century ago when foreigners regarded Great Britain as the main source of manufactures made by machinery. She was a large consumer of food and raw materials which she obtained in exchange and without much trouble. The demand, in short, on the part of the foreigner for British goods a century ago was highly inelastic ; to-day it is the reverse. He has other countries from which to purchase. Manufactured goods have been imported in more recent years from abroad for which the demand was far more elastic than the case of the imports of food, such as wheat and flour from the United States and Canada. These manufactured goods were in competition with goods manufactured in Great Britain, and in the trade depression these foreign-made goods were being sold there at prices which the British manufacturer could not compete. Japan, for example, was selling in Lancashire cotton goods at prices which defied competition with the best of Lancashire's mills. From 1932, therefore, Great Britain has turned to protection, and has limited also by quotas her imports of food and other materials from foreign countries primarily in the interests of herself and to a less degree of other parts of the British Empire. Elsewhere we have seen that a foreign producer may pay import duties in whole or in part if the importing country offers a sole market for his produce, but such conditions are very rare. Foreign producers will seek new outlets if the market owing to the tax becomes less profitable, and consequently the consumers in the country levying the tax must pay the taxes imposed by their own governments if they desire these goods. It is in reality only where the importing country has a buyer's monopoly or where the exporting country has a selling monopoly that the burden can be shifted from the home consumer to the foreign producer. From the revenue point of view protection is inimicable to high customs returns.

A country by imposing duties on its exports may obtain a contribution from buyers abroad if the demand for the exports is highly inelastic. If it is considerable it is a strong argument in favour of continuing export duties.

If customs duties are to be regarded from the revenue point of view only they should be imposed on necessaries and at as low a rate as possible. As a general rule if levied on a small number of articles they may form a system of productive taxation. There are one or two characteristics of these duties which demand attention from the student of finance. Duties which are imposed for revenue purposes must be levied on articles of general consumption, and a greater proportion of small incomes than of large incomes is spent on such commodities. In other words, the burden of these duties instead of increasing from a low charge on small incomes to a very high charge at the end of the income scale advance little by little and soon reach a maximum. The smaller the income the larger is the rate upon it which these duties represent. They are therefore regressive. Another characteristic is their effect on industry. If the duties are high and of a protective nature they raise questions of the disposition of capital and labour which it is not possible here to analyse. The duties are also inelastic and are unable like income tax to meet unusual demands upon the National Exchequer. They are subject also to the disadvantage that when Government's requirements are greatest, as in war, they yield least. The disturbance following on war causes a reduction in international trade, with the consequent effect on customs as revenue. In times of depression, too, they decline and increase the financial difficulties of the National Exchequer in preserving Budget equilibrium.

CHAPTER XXVII

EXCISES OR INTERNAL TAXES ON CONSUMPTION

1. THE indirect taxes dealt with in this chapter are excises or internal duties on consumption, government monopolies, and octroi duties. In financial literature the expression excise or excises is somewhat indefinite. By "excise" is ordinarily meant a tax or duty on home-produced goods, either in the process of their manufacture or before their sale to consumers, especially on spirits, beverages, gasoline, sugar, and tobacco. It includes also certain licences, commodities, and licences to conduct certain trades. It is usual to exclude from excise or excises sales or turnover taxes. It is usual in Continental financial literature also to exclude from this head taxes which although taxes on consumption are Government monopolies. Thus in the case of Italy the heading taxes on consumption excludes the Government monopolies of tobacco, cigarette papers, salt, quinine, public lotteries, matches and automatic lighters. Similarly in Spain the Government monopolies of tobacco, matches and automatic lighters, petroleum, and medicaments are excluded from the proceeds of "internal taxes", viz. those on sugar, alcohol, beer, chicory, gunpowder and explosives, and consumption taxes generally. In Turkey the expression excludes the monopolies of tobacco, salt, alcohol, liquors, matches and lighters, arms and explosives, which are excluded from taxes on consumption and turnover. Hungary also excludes from turnover and consumption taxes the Government monopolies of tobacco, salt, and saccharine. In Czechoslovakia the government monopolies of tobacco, salt, saccharine, and explosives are excluded from consumption taxes. In Great Britain excise includes excises on home-produced goods—beer, spirits, patent medicines, table waters, entertainments, matches, liquor, and licences to conduct certain trades or professions, such as those

of pawnbrokers, moneylenders, auctioneers, tobacconists, wine-dealers, publicans, brewers, distillers, house-agents, hawkers, gamekeepers, game dealers, and plate dealers, and also licences for dogs, guns, and game. In India excise excludes salt. It is, in short, the general rule to exclude sales or turnover taxes from excises, and in the case of countries with Government monopolies also to exclude these.

The following table gives the percentage of total tax revenue derived from excises :

PERCENTAGE OF TOTAL TAX REVENUE DERIVED FROM EXCISES

Country	Year.	Excises (millions).	Percentage of total Tax Revenue derived from Excise
United States	1932-33	\$724	39
Holland	1934	Fl. 179	35
Japan	1933-34	Yen 314*	31
Germany	1932-33	R.M. 1287†	26
Australia	1933-34	£12	21
France	1934	Fr. 7189*	20
Czechoslovakia	1933	Kr. 2015*	20
Italy	1933-34	Lire 2929*	18
Belgium	1932-33	Fr. 1319	16
Great Britain	1933-34	£107	15
Canada	1933-34	\$35	13
Hungary	1932-33	Pengo 81*	12

* Excludes government monopolies. If monopolies were included the percentages would be considerably higher in Japan (40 per cent), France (27 per cent), Czechoslovakia (33 per cent), Italy (38 per cent), and Hungary (31 per cent).

† Excludes R.M.138 millions from liquor monopoly

In making comparisons between countries it is essential to see precisely what is included under the term "excise" or excises, and in federal constitutions whether both central and state excises are included. In the table above only national and federal excises are included, and Government monopolies have been excluded as in the case of Hungary, Czechoslovakia, Italy, France, Germany, and Japan. In the United States, Holland, and Japan excises are of the order of one-third the tax revenue and one quarter in Germany, Italy, and Australia. They are of less importance in Great Britain, Canada, France, and Hungary.

During the nineteenth century excise taxes were made more equitable, and as a result of greater administrative efficiency very much more certain in the production of revenue. The principles

underlying such taxation are those conforming to the canons of a good tax. In this case in order to make excises productive they must be in the first place articles widely consumed. If the articles on which the taxes are levied are widely consumed, the tax burden will be spread among the general body of taxpayers. These excises, too, should fall on consumers' goods rather than on auxiliary capital goods. The tax is on consumers and should be on goods ready for consumption. Excises or taxes on commodities of domestic manufacture may be levied on the raw materials or at an intermediate stage of their production or when the articles are ready for consumption. When it is imposed at the first of these stages it is usually on the area under cultivation or on the quantity of the raw material produced. The disadvantage of taxing at this stage is that the tax is collected at the beginning of the productive process often long before the goods are sold. On the other hand, the taxation at this point may drive producers to improve the productive processes in order that the manufacturer should bear a less share of the tax by increasing the output per unit of the raw material. When the tax is levied at the last two stages the period for which it is advanced by the manufacturer is curtailed. The advantage of applying the tax at the later stage is that differences in quality can be taken into consideration so that higher rates may be levied on the better qualities. The taxes should be levied in accordance with the canon of convenience. The practice, for example, of storing goods under bond makes it possible for the producer to withhold the tax until the article is withdrawn for sale. In order to prevent evasion it may not be possible always to collect the tax close to the place of consumption but at the place where it is most concentrated. This may mean a longer chain of dealers before shifting takes place and therefore greater charges for what is called the carrying of the tax. It will, however, mean economy in collection. Another principle of the taxation of commodities produced internally is that as far as possible the articles to be taxed should be conventional necessities such as drink and tobacco, except perhaps in the case of salt, at any rate in India, which gives a constant and adequate flow of revenue easily expansible when required. The tax of primary necessities such as wheat and flour is to be avoided as far as possible. The taxation of articles of primary necessity interferes with the cost of the

breakfast table of the lower classes of taxpayers and it is not desirable to impinge on this standard. A tax, in short, on necessities such as food and candles does not operate in the same way as a tax on luxuries since it may effect the standard of living while a tax upon luxury does not. In times of financial strain taxes on necessities are a means of considerably increasing the public revenue because they are largely on commodities of mass consumption. After the World War the requirements of the budgets made excise more popular as a form of taxation in order to lighten the burden of the prevailing high progressive taxation, such as that on income and on inheritance.

Excises cannot be expected to be capable of an increase in the same way as income tax, and although individual articles, such as beer and spirits, may yield in times of necessity larger revenue they are only elastic up to a point. Consumption taxes, however, are regressive in that their burden is relatively higher on those of lower incomes because the expenditure on necessities absorbs a higher proportion of income in the lower ranges of income than in the higher, but, on the other hand, it is to be remembered that the poorer taxpayer is often able to shift the burden of the tax on to his employer or the general public by raising wages to meet the cost of living. They are less irritating to the taxpayer than the income tax as they are passed on to the consumer in the form of high prices. He pays the tax in small dribs and drabs. They are, in Adam Smith's words in regard to the taxation of luxuries, "all finally paid by the consumer and generally in a manner that is very convenient for him. He pays them little by little as he has occasion to buy the goods." Among excises those on drink and tobacco are the most productive and most elastic. In times of necessity spirits and tobacco can be called upon to produce more revenue. In recent years there has been discovered one excise which is prolific in all countries of industrial importance, and that is the tax on petroleum or gasoline, which is also convenient and within limits elastic. All states, for example, of the Union have a gasoline tax and all motor fuels are taxed. In many cases kerosene is exempted. The proceeds of the tax is in one half of the states of the Union entirely used for state roads, as in Connecticut, Delaware, Kansas, Kentucky, Massachusetts, Michigan, Minnesota, Wisconsin, Missouri, Rhode Island, Virginia, North Carolina, and

other states. In some states a share goes for the upkeep of country roads. Thus in New York 75 per cent of the proceeds is used for state roads, 5 per cent for New York City general purposes, and the remaining 20 per cent is used by the State for general purposes. In Columbia the whole of the proceeds goes to the general fund. The rate varies ordinarily from 2 to 7 cents per gallon. The revenues from state gasoline taxes in the states of the Union have increased remarkably in the last fourteen years. The increase is due in some measure to the enormous number of states which introduced this form of taxation from the year 1925. In 1920 the revenue was \$1,363,902 ; in 1925 the revenue was \$148,358,087 ; in 1931 \$536,397,458 ; and in 1934 \$565,027,800. The following table shows the popularity of this tax at a glance :

GASOLENE OR PETROL TAXATION AND REVENUE FROM MOTOR REGISTRATION IN STATES OF THE UNITED AMERICAN UNION, 1920-34

Year.	Revenue from Gasolene Tax	No. of States levying Tax.*	State Motor Registration Tax.	Tax rates, cents per gallon
	\$ Millions		\$ Millions	min.-max.
1920	1.3	5	102.5	½ 1
1921	5.4	15	122.5	½ 2
1922	12.7	19	152.0	½ 2
1923	38.6	34	188.9	½ 3
1924	80.4	35	225.5	1 4
1925	148.3	44	260.6	1 4
1926	187.6	44	288.2	1 5
1927	258.8	45	301.1	1 5
1928	304.9	46	322.6	2 5
1929	431.3	48	347.8	2 6
1930	494.7	48	355.7	2 6
1931	536.3	48	344.3	2 7
1932	513.0	48	292.9	2 7
1933	518.2	48	266.1	2 7
1934	565.0	48	261.2	2 7

* Since 1924 the District of Columbia (not included in Col. 3 but in Col. 4) levied the tax

The popularity of the tax may be illustrated from other countries such as England and France. In France the tax brought in 1032 million frs. in the year 1933. This form of taxation is taken largely from a class which can afford the luxury of automobiles, and it provides some portion of the expenses of road maintenance, the cost of which has in recent years greatly increased with the extension of mechanical transport.

The main characteristic of modern excise systems is the great importance given to duties on wines, spirits, beer, and tobacco. Necessaries, such as sugar and salt, are also frequently taxed. But the number of articles which produce revenue is not large, and the extreme simplicity of Great Britain in this respect is very noticeable. The duties on wines and spirits promote sobriety as they prevent consumption, which would probably increase were there no tax. It is sometimes contended that States look too much to the financial results of their liquor policy, and, although they may spend their revenue on education and other social services, prohibition will never receive any effective support. The State realises that the drunkard is never a good taxpayer, except through the drinkshop, as his work is bad, his home poor, and his family has little to spend on necessaries on which indirect taxes are frequently imposed. While realising, too, the effects of decreased consumption on improving the economic condition of its citizens, it always insists that high drink duties mean illicit traffic unless accompanied by larger expenditure on more efficient administration. Each country, however, must survey its own particular problems and its own financial necessities before it decides on a revision of the form of its internal taxes on consumable goods.

2. Indirect taxation in England is usually said to have been introduced from Holland by Pym in 1643 when the Long Parliament resolved on the 28th March to have a system of excise duties.¹ An ordinance of the same date imposed duties on ale and beer, cider and perry, strong waters, and several other articles. In January 1644 flesh, victuals, and salt were added, and in July of the same year alum, hops, saffron, starch, silks, etc., were added. Before this period, however, indirect taxation existed to some extent, although there was a traditional hatred to taxes of this sort in the form of monopolies, which constituted one of the methods of raising taxes on consumable goods, granted even before the time of the Tudors. It was, however, only under

¹ Before this period there were traces of excise duties. In 1610 a petition of remonstrance was submitted to King James by the Commons: "Your Majesty hath lately and in time of peace, set both greater impositions and far more in number than your ancestors". They complained especially of the internal tax on coal at the pit, "the reason of this precedent may be extended to all commodities of this kingdom". Cf. Dowell, *History of Taxation and Taxes in England*, vol. i. p. 218, and vol. ii. (Bk. I.).

the Tudors that they were abused, especially under Elizabeth. In 1601 the list of monopolies included salt, currants, iron, playing-cards, vinegar, and coal, and it is on record that the salt monopoly raised the price from 1s. 4d. to 14s. or 15s. per bushel. Queen Elizabeth promised to revoke all objectionable patents. James I., who strongly disliked the use of tobacco (which was introduced into England in 1565), exacted from importers of tobacco from Virginia, but not from Spain and Portugal, a heavy import duty of 6s. 10d. per lb., but it was not until later that tobacco licences were introduced. In 1634 "the tobacco licences go on apace ; they yield a good fine and a constant yearly rent".¹ The taxation of tobacco produced in 1732 £754,000 from a duty at 6½ pence per lb., but owing to a very fraudulent system of drawbacks and smuggling the net production was only £160,000. In 1634, however, a company obtained a monopoly for salt. It was not until 1639 that most of the monopolies were revoked by proclamation, and the civil war that followed put an end to that troublesome matter. The system of excise duties introduced by the Long Parliament became not unpopular, and it prevented the wealthy landed classes from paying the heavy taxation that would have been required from them during the next two centuries. Consumers almost failed to realise that they were paying taxes. At first ale and beer, cider, perry, and strong waters were taxed, and this was followed by numerous articles of food and clothing, e.g. flesh, victuals, salt, alum, hats, starch, saffron, and silks. Between the Restoration (1660) and Sir Robert Walpole's excise scheme (1733) the tendency was to increase the list of articles. Walpole attempted to curtail the list. He also brought forward a Bill, generally known as the Excise Scheme (1733), to introduce what is now known as the Warehousing System, applicable first to tobacco and then to wine. This system was to decrease the frauds from smuggling and from drawbacks. The collection of the revenue was to have been cheapened and made more easy. The small loss to the State would be more than outweighed by the saving in the cost of collection and in the prevention of fraud. There was strong opposition, and there were fears that there would be a large army of revenue officials. There was a popular cry at the time of "no slavery, no excise, no wooden shoes", and did

¹ Stafford Letters quoted by Dowell, *History of Taxation and Taxes in England*, vol. iv. p. 270 (Longmans, Green & Co., London, 1894).

not Dr. Johnson define excise as “a hateful tax levied upon commodities, and adjudged not by common judges of property, but by wretches hired by those to whom excise is paid”? Walpole dropped the scheme. “I will not”, he said, “be a minister to enforce taxes at the expense of blood.” During the eighteenth century, especially owing to the wars with France, it was necessary to increase the excise duties. By 1792 they were £10,000,000 as against a shade over £1,000,000 in 1700. Glass, tiles, leather,

	Net Receipts from Excise,* 1933-34	% of Tax revenue.
	Millions	
Beer	53·9	7·6
Spirits	29·1	4·1
Entertainments †	9·2	1·3
Matches	2·1	
Artificial Silk	3·3	
Sugar	1·7	
Medicines	0·7	
Table Waters and Cider	0·3	
Other sources ‡	6·6	
Total	106·9 or 15·1% of tax revenue.	

* Includes the direct taxes, viz. licence duties, etc., amounting to £4,900,000. If this were excluded, excise amounts to £102,920,000 or 14·4 per cent of tax revenue.

† These are dealt with separately in Chapter XXVIII.

‡ Includes duties on tobacco, playing-cards, chicory, and coffee mixtures or substitutes.

soap, candles, salt, and other articles had been added to the inland revenue schedules. The tax on salt, which continued from 1694 to 1729 (when it was repealed, only to be renewed in 1732), was comparatively light. During the American War it was increased to 5s. per bushel and continued at this rate until 1798, when it was raised to 10s. Pitt in 1805 increased the rate to 15s.¹ at which rate it continued until its repeal in 1825. The excise duties, thanks to the efforts of Huskisson, were reduced, and between 1830 and Gladstone's Financial Statement, 1861, excise duties on leather, candles, starch, bottles, glass, bricks, soap, and paper were abolished. A tax on soap was sometimes condemned as a tax on cleanliness, and a tax on paper as a tax on knowledge.

¹ At this rate the tax was about 30 times the cost of production, which was only 6d. per bushel. A Committee of the House of Commons (1801) dealt with the smuggling and the salt laws generally.

The hop duty was abolished in 1862, and the malt tax was removed in 1880. The tobacco duty¹ is from home-grown tobacco. The excise duties² at the present time are shown on page 659.

The Excise Department was under the Board of Inland Revenue, but from 1st April 1907 it has been amalgamated with the Customs Department. The control of British excise, therefore, is now under the Board of Customs and Excise.

3. In some other parts of the British Empire excise duties have long been in force. In the younger colonies the need for such duties has not arrived, but the experience of self-governing Dominions and India will be very useful in this respect. In the self-governing Dominions, as we have already seen, excise is a central head of revenue and amounts to one-fifth, or about one-fifth, of the total tax revenue.

In Canada the excise tariff is confined to spirits, malt liquor, tobacco, cigarettes, Canadian twist tobacco, snuff and cigars. There are in addition to this, excise war taxes levied on matches, automobiles, ale, beer and porter, whisky, playing-cards, etc. Druggists and manufacturers of patent medicines are allowed a drawback of 99 per cent of duty when spirits testing not less than 50 per cent over proof are delivered in limited quantities to universities, scientific or research laboratories, or hospitals for medicinal purposes only. Spirits and tobacco alone were 80 per cent of the total inland revenue in 1913, 65 per cent in 1920, and 75 per cent in 1927. The excise revenue, including the indirect excise war taxes, was more than 17 per cent of the total tax revenue.

In Australia the Commonwealth excise revenue is confined to beer, spirits, tobacco, and starch, and also some direct taxes, as in the case of Great Britain, namely licences. The excise revenue in 1933–34 was 23 per cent of the Commonwealth tax revenue. Excise duties were increased from 25th September 1918. In 1925–26 beer yielded more than half, and tobacco slightly less than one-third, of the Commonwealth excise revenue. Since 1917–18 the revenue from these two items has trebled itself. In New Zealand excise duties are confined to beer and tobacco and its preparations. By the Customs Amendment Act, 1921, excise duties were no

¹ For the rates of excise duty on different articles see Reports of the Commissioners of H.M.'s Custom and Excise, H.M. Stationery Office, London.

² For the detailed history of taxes on eatables, drink, tobacco, and others, refer to Dowell's *History of Taxation and Taxes in England*, vol. iv. (Longmans, Green & Co., London, 1884).

longer levied on certain manufactures the preparation of which involve the use of a considerable proportion of spirits. A special reduced schedule of duties is provided on alcohol imported for use in warehouses manufacturing articles such as perfumed spirits, toilet preparations, culinary and flavouring essences, and similar preparations. The excise duties amounted to 14 per cent of the total Commonwealth and State tax revenue in 1933-34.¹ About 90 per cent of the excise revenue is collected from beer. All packages of manufactured tobacco must be labelled before leaving the manufactory, and it is necessary to obtain warrants to use cutting machines for cutting duty-paid manufactured tobacco for sale. The Commonwealth revenue from excise was £127,041 in 1914 and £11,928,000 in 1933-34, or over half that of Customs (£22,327,000) out of a total Commonwealth revenue of £56,409,000.

In the Union of South Africa excise duty is confined to spirits, beer, tobacco, cigarettes, sugar, matches, playing-cards, acetic and pyroligneous acids, and patent medicines. The Cigarette Excise and Surtax Act, 1911, applies throughout the Union, and the tax is collected from the manufacturer by means of stamps affixed to the container before cigarettes leave the factory, or from the importer at the time of first importation or delivery from a bonded warehouse. Manufacturers overseas are allowed to purchase the necessary stamps, and affix them to the containers of cigarettes at the time of manufacture. The excise duty for every one-half ounce net weight or fraction thereof is $\frac{3}{4}$ d. on all cigarettes manufactured in the Union, and on cigarettes imported into the Union and delivered for consumption therein a surtax (in addition to the duty payable under the Customs laws) is levied for every one-half ounce net weight or fraction thereof. The duty on Union-made matches is 1s. per gross of boxes containing not more than 100 matches, 2s. per gross of boxes containing more than 100 matches and not more than 200 matches, and an additional 6d. per gross in the case of every additional 100 matches. The excise duty on spirits is important both from the financial and from the prohibition point of view. The rates are so graduated as to encourage the distillation of wine brandy and to prohibit the distillation of dop brandy or brandy from materials other than the vine. A full rebate is granted in the case of spirits exported for consumption outside the limits of the Union, or used

¹ The percentage in the table on p. 653 refers to Commonwealth excises only.

for industrial purposes and rendered unpotable or methylated or used for the purposes of fortification and preservation of pure wine. There are also licences under excise as in the English system, e.g. the liquor licences which are assigned to the provinces. The excise revenue of the Union Government in 1925–1926 was £1,803,000 or 9·5 of the tax revenue, and was about three times the excise revenue for the year 1913–14. Spirits, cigarettes, and tobacco yielded 76 per cent of the total excise revenue in 1925–26. Excises are not of any great importance as a source of revenue in the Union as income tax, the excess profits tax of gold mines and gold-mining leases were in 1933–34 62 per cent of the Union's taxation.

In India excise duties are derived from the manufacture and sale of spirits, hemp, drugs, opium, matches, and salt, although the salt tax is administered independently of excise. Opium and salt are government monopolies. There is as yet no excise duty on tobacco grown or manufactured in the country, nor on betel (*pansupari*), which is chewed by all classes of the population. Since the introduction of the Constitution of 1919, excise other than salt is a provincial source of revenue, while salt itself was wholly a central head, but under the Government of India Act, 1935, salt and other federal excises may be assigned in whole or in part to the Units.¹ Opium is to all intents and purposes no longer a source of revenue, because it was decided, at very considerable loss to Indian revenues, to restrict the cultivation and export of opium, China undertaking to curtail its production as well as its imports. It is doubtful whether China has fulfilled her agreement in regard to this. The anti-opium crusade was led in the United Kingdom by those to whom Sir John Strachey applied the words of Condorcet, "the ignorant enthusiast is the most terrible of ferocious beasts" ("l'enthousiaste ignorant est la plus terrible des bêtes féroces"). The excise duty on spirits is of long standing, and inherited, like the salt revenue, from the days of pre-British rule. References to intoxicating liquors are found in the Mahabharata and the Ramayana, and the British Administration got from its predecessors a system of farming, the right of manufacture and sale being given to the highest bidder. The general policy in recent years has been to adjust rates and methods to check the practice of excessive drink, and at the same time to

¹ 25 & 26 Geo. V., § 140.

safeguard revenue without encouraging illicit manufacture. In India country spirit, the produce of the distilleries, is the main source of revenue, yielding one-third of the total receipts from the sale of liquor. In the Madras Presidency alone fresh toddy from the coconut palm yields more than country spirit. The system in force is known as the contract distillery system, under which the manufacture of spirit for specified supply areas, determined according to convenience, is disposed of by tender for a definite period. In the most advanced province of India—the Bombay Presidency—a system of rationing coupled with Government management of certain large distilleries has been introduced since 1922. Prohibition is gaining ground in the reformed Councils, and it is only finance that stands in the way. The Excise Committee¹ of the Bombay Presidency issued its report in 1924, and advocated gradual prohibition—the Rs.3 crores of revenue from excise to be made up from a succession duty which it estimated would yield Rs.50 lakhs annually ; a totalisator tax (Rs.20 lakhs) ; the taxation of “futures” (Rs.50 lakhs) ; an increase of the local fund cess (Rs.30 lakhs) ; a tobacco tax (Rs.5 lakhs) ; an employee tax (Rs.40 lakhs) ; a transit tax (Rs.20 lakhs) ; and a terminal tax (Rs.50 lakhs). The Committee thought that the natural growth of revenue would make up the difference between Rs.3 crores and the sum-total of the above. This, however, was not given effect to, and this policy has not been successful since prohibition is impossible. In the attempt at this policy considerable revenue has been lost to the Government as the provincial revenues were yielding less than was otherwise possible. Drugs,² which also bring in revenue, are controlled. Of these, charas has been prohibited in the Bombay Presidency, excluding Sind, since 1922.

Salt, which Homer calls “divine”, and Plato a substance dear to the gods, has been taxed from very early times, just as in the Roman Imperial times “salary” represented the allowance of salt made to officers and men in the Roman Army and which was afterwards converted into a money payment. In India, as the

¹ Report of the Excise Committee appointed by the Government of Bombay, 1922-23 (Bombay Government Central Press, 1924).

² I.e. ganja (flowery tops of the cultivated female hemp plant), charas (resinous matter which forms an active drug when collected separately), and bhang (dried leaves of the hemp plant, whether male or female, cultivated or uncultivated).

population is largely vegetarian, and therefore requiring salt to an extent not required by meat-eating and milk-drinking people, salt is of importance. The consumption per head, according to family budgets collected by the Labour Office of the Government of Bombay, comes to 12 lb. per annum. The incidence of the tax is light. The average 20 years ago was only 4·9 annas per head of population, while in 1923–24 it was 5·7¹ annas. The recent reduction from Rs.2·8-0 in 1923–24 to Rs.1·4-0 in 1924–25 has brought down the incidence per head. According to the Finance Minister in his Budget speech in the Legislative Assembly, 1924, the increase in the salt duty to Rs.2·8-0 did not produce any decrease in consumption. At the present time most of the salt produced is manufactured under direct Government agency, and the remainder under a system of licences issued to contractors. There is a considerable amount of salt imported into Bengal and Burma from Europe and Aden, where, owing to the difficulty of manufacturing salt in the damp climate of Bengal and the large volume of fresh water poured by the Ganges and the Brahmaputra into the Bay of Bengal, manufacture is difficult.² Preventive establishments are maintained to restrict illicit traffic. Until 1st April 1924 salt and excise formed one Department, although salt is a central and excise a provincial head of revenue. Excise is a transferred subject under the reforms of 1919, and the result of the amalgamation was a weakening of the control of the Minister in charge of the Excise Department and also the deprivation of the Legislative Council of its statutory right of checking in detail the expenditure of the Department. In order to avoid disagreement between the Honourable Member of the Executive Council responsible for salt and the Honourable Minister responsible for excise, the two Departments were de-amalgamated, with effect from 1st April 1924. Salt is, as we have seen, a central head of revenue.³

The cotton excise duty dated from 1894. In December of that year, when the financial situation made it imperative to place import duties both on piece-goods and yarn to the extent of 5 per cent, an excise duty of the same amount was placed on the Indian yarn of counts above 20s. The Finance Minister, Sir James

¹ Based on revised estimates.

² Salt is also used in place of ballast for ships coming to Calcutta for exports of jute, tea, rice, etc.

³ But cf. Section 140 Government of India Act, 1935, where the whole or any part of the net proceeds may be distributed among the Units.

Westland, explained in introducing the Excise Duty Bill, that the policy underlying its provisions had been imposed on the Government of India by the Secretary of State in pursuance of a Resolution of the House of Commons. In 1896 the import duty on cotton piece-goods was lowered to $3\frac{1}{2}$ per cent and an excise duty at the same rate was placed on Indian-made cloth. Cotton yarn was admitted free of duty and no countervailing excise

Items.	Excise Revenue, Rs.000. 1933-34.	Percentage to Total Tax Revenue.
<i>Excise—</i>		
Licence and distillery fees and duties for the sale of liquor	1051,52	31·8
Gain on sale proceeds on excise opium . . .	256,94	7·8
Duty on hemp and other drugs	158,86	4·8
Miscellaneous	49,24	1·5
<i>Salt—</i>		
Excise duty on salt manufactured locally . . .	565,04	17·1
Duty on imported salt	282,12	8·5
Sale of Government salt	45,34	1·4
Miscellaneous	13,42	0·4
<i>Opium—</i>		
Sale of opium	114,94	3·5
Cost price of opium sold to the Excise Department	42,77	1·3
Miscellaneous	1,26	..
<i>Others—</i>		
Excise duty on motor spirit	442,79	13·4
Excise duty on kerosene	280,68	8·5
Miscellaneous	53	..
	3305,45	100·0

duty on Indian-made yarn was accordingly imposed. The excise duty remains at this level, although the import duty for cloth was raised to $7\frac{1}{2}$ per cent *ad valorem* in 1917, and to 11 per cent *ad valorem* in 1921. In 1922 cotton yarn, which had since 1896 been free, was subjected to an import duty of 5 per cent *ad valorem*. The cotton excise duty was always regarded with disfavour because of its history. It was noted that there was no duty existing on jute manufactures, although from the point of view of the incidence of the tax this could have been perhaps justified to a greater degree than the cotton excise duty. The duty was suspended from 1st December 1925 and subsequently abolished.

4. Excise duties in France may be grouped under two heads, those produced under monopoly conditions (undoubtedly a form of taxation) and those taxed as ordinary excise duties. To the former class belong tobacco, matches, and gunpowder, and to the latter sugar, salt, drinks, petroleum, the consumption of gas oil, benzol and benzine, and miscellaneous articles such as medicines, candles, passenger traffic, and playing-cards. The figures are as follows :

	1928 (million francs)
Tobacco	3985
Matches, etc.	252
Gunpowder	165
Sugar products and Saccharine . .	1135
Salt	128
Mineral Waters, etc. . .	2684
Miscellaneous	276
	<hr/>
	8625
	<hr/>

Other indirect taxes, which hardly can be classified as excise, are dealt with below. It is perhaps advantageous to refer briefly to these taxes. The tobacco monopoly produced, it will be seen, very considerable revenue, incomparably greater than that relating to matches and gunpowder. Of the excise duties other than monopolies those on beverages such as wine, beer, cider, perry (pear cider), mead, alcohol, and mineral waters and sugar are of importance, and the miscellaneous group, such as pharmaceutical preparations, candles, cycles, passenger traffic, playing-cards, is not inconsiderable. Salt produced only 157 million francs in the year 1934. Owing to exemptions to persons and local discriminations, and also to other defects in administration, these duties were abandoned during the Revolution. The salt tax, for example, was abolished in March 1790, but restored in 1806 without being any longer a monopoly and without the old inequalities between the various provinces in France. The excise duty on liquors was re-established in 1804, and six years later the State monopoly of tobacco was also re-established. The salt duty or gabelle can be traced as far back as 1286, and Charles V. made it a permanent source of revenue. The fact that it was made obligatory on every individual to purchase weekly salt at a fixed price made

the tax an inconvenient and unpopular one. From 1342 a State monopoly was begun by establishing storehouses in each province where the producer was compelled to store the salt on pain of confiscation. The State paid the producer and sold the salt at a higher rate to retailers. In one group of provinces it was heavy, in another it was less heavy, and in others it was redeemed or no tax was levied at all. Some of these taxes, such as those on drinks, *i.e.* on spirits and beer, are taxes at the point of manufacture, as in England. Other taxes, however, are levied so lightly that it is questionable whether they could not be replaced by better taxes. The French excise taxes not only contribute to the State but also to local finances, and those on drinks, tobacco, and sugar are well administered. Other taxes of the nature of octrois are dealt with in a subsequent paragraph.

5. In Italy there are monopolies on tobacco, salt, public lotteries, quinine, matches, automatic lighters, and cigarette paper, in addition to excise duties. The manufacture of matches is entrusted to a merger under State control. The tax is paid through stamps placed on the packages. The tobacco monopoly is a very profitable one, amounting to 2495 million lire in 1933-34, as compared with 321 million lire from salt, 519 million lire from lotteries, and 122 million lire from matches and automatic lighters. The excise duties are mainly from spirits, beer, mineral oils, sugar, gunpowder and other explosives, coffee and chicory substitutes, filament and arc lamps, glucose, seed oils and acetic acid. By the law of October 1925, a five per cent share of the proceeds from sales of tobacco products within the Kingdom is received by municipalities. Since 1928, monopolies are worked by an autonomous body and their budget forms an appendix to the general budget. From the same year also proceeds from the tobacco and salt monopoly are classified into two groups: viz. (1) industrial or commercial revenue and (2) tax revenue. For taxation purposes costs of production in the case of tobacco are estimated at 21 per cent of the gross income, and the income thus at 79 per cent for salt, the percentages are respectively 20 and 80. There is in addition a system by which the State obtains revenue from octroi. The State grants to the communes one-tenth of the proceeds of the tax on incomes as compensation for communal revenues made over to the State by various laws. A criticism may be made of the comparative heaviness of this tax from a

population even as poor as the Italian is said to be. But there are circumstances which preclude the collection of high duties like those on spirits in the United Kingdom. In short, we come back to the theory explained in a previous chapter, that local circumstances have to be taken into consideration in the selection of the commodities, as well as the taxes to be levied on those commodities, in any excise system. In Spain and other countries monopolies are still in use and bring in considerable amounts of revenue. In Federal Germany the main indirect taxes are of an excise nature on tobacco, beer, wines, and a somewhat lucrative tax on coal ; but this does not include all the taxation, as State revenues are not included in these figures. The salt monopoly, which was changed in 1867 into a tax on the article, is still retained. There is also a sugar duty. In other countries of continental Europe drink duties and those on tobacco and sugar are the main source of excise. There is a tendency for greater uniformity than formerly, as the financial experts of various countries watch the duties levied with considerable interest. In Japan the main excise duties are those on liquors, soy, sugar, the consumption tax on kerosene oil—*i.e.* upon persons taking delivery of kerosene oil from factories, custom-house compounds, bonded warehouses, custom depots, or places where the storage of foreign goods is permitted by law—the tax on patent medicines and textiles, a consumption tax already referred to, together with the travelling tax on passengers by steam trains, electric cars, and steamboats according to the distance travelled and according to the class.

6. In China the main excise tax is the salt gabelle. The tax, indeed, is very old. It is said that the salt monopoly was created by Kuan Tsi, the Prime Minister of Tsi State (now the Shan-tung province) during the Eastern Chow dynasty 770–249 B.C.¹ Since then the salt monopoly has continued to be one of the most important sources of public revenues in China. Up to 1913 the tax was administered in a most inefficient way and a great deal of smuggling took place. The rates varied from province to province. Thus, for example, the rate was only \$0·7 per 100 cutties of salt in the three eastern provinces, while in Ao-yan of Huai-nan it was as high as \$5·1 for the same quantity. The average yield

¹ Cf. *The System of Taxation in China in the Tsing Dynasty, 1644–1911*, by Shao-Kwan Chen, Ph.D., New York, Columbia University, 1914, p. 79.

from this source for the twenty years preceding 1913 was approximately \$17,000,000. The whole system was completely reorganized in 1913, and the principle of uniform taxation at the source or the imposition of a single direct salt duty in the producing districts was definitely adopted by the Chinese Government. Since then the tax has shown remarkable progress. In 1916, three years after its reorganisation, it yielded about \$71,000,000, or more than four times what it produced in 1913. The estimated revenue for the year 1932-33 from the salt gabelle was \$152,000,000 or about one-fourth of the total tax revenue, and this was next to customs which produced \$310,000,000. Wine, tobacco, and stamp taxes yielded in the same year \$22,000,000; mining taxes, \$989,000; and rolled tobacco and other consolidated taxes, \$82,000,000. Salt taxation is thus much more than all these other internal taxes combined.

7. A reference has already been made to Japan. It remains to summarise briefly the main excise duties at present in force. The revenue for the year 1933-34 was approximately as follows:

		(Yen millions).	Percentage.
Sake (liquors, etc.) . . . . .	.	208·9	42
Profits of Monopolies . . . . .	.	179·3	36
Sugar . . . . .	.	72·5	15
Textile Fabrics . . . . .	.	29·4	6
Table Waters . . . . .	.	3·2	1
		493·3	100

These duties far exceed the revenue obtained from customs, as the customs duties¹ are framed on a protectionist basis. The tax on liquors is a tax imposed upon persons brewing sake, beer, and alcohol, and alcoholic liquors. No tax is levied upon wine or other alcoholic liquors made from fruits of all kinds. The revenue from monopoly is based on the Tobacco Monopoly Law of 1904. Government controls both the manufacture and the sale of tobacco. The cultivation of leaf tobacco is allowed to private individuals under permission of Government, and the leaf gathered by them is taken over by Government, suitable compensation being paid therefor, according to the quality of the leaf. The leaf is then manufactured at a Government

¹ Customs duties were yen 114 millions only in 1933-34.

Factory and sold at fixed prices by licensed dealers. Foreign tobacco cannot be imported except by Government or persons appointed by the Government for that purpose. Similarly tobacco can be exported only under licence. Nearly fifty years ago tobacco regulations were issued in Japan, and the present system has developed mainly since the date of the abolition of the tax in 1898. The Salt Monopoly Law, like many other financial measures of the Government of Japan, was introduced after the war with Russia when the necessity for increased revenue was pressing. Salt is manufactured only by persons licensed by Government, which buys the article from them at fixed prices according to its quality. Government sell the salt to licensed dealers. Foreign and Formosa salt cannot be imported except by Government or a person appointed for the purpose by Government. For the purpose of export salt can be exported by any person. Salt required for industry, agriculture, mining, or fisheries receives special treatment by being sold at reduced prices. Since 1918 the policy of profit-making has been abandoned in regard to salt, and the monopoly is now so managed as to cover expenditure and nothing more. Under the Camphor Monopoly Law, which dates from 1903, the manufacture of crude camphor and camphor oil is permitted only to persons licensed by Government, and Government takes over the article by paying suitable compensation according to quality. Crude camphor or camphor oil is sold by Government to refiners at fixed prices. A large amount of the Japanese camphor is consumed in the home market, and the produce of Formosa is exported mainly to Europe and America. Sugar excise, which dates from 1901, is imposed on sugar molasses and syrups removed for the purposes of domestic consumption from factories, custom houses, and bonded warehouses. The Textile Tax, which dates from 1905, is levied at the rate of 10 per cent upon textile goods for domestic consumption taken from factories, custom houses, and bonded warehouses. In April 1926 the tax on cotton fabrics was discontinued. The travelling tax is similar to the travelling tax in England, and dates from 1905. It is imposed upon passengers by steam trains, electric cars, and steamboats.

8. The system of excise duties, known as octroi, should be considered in any discussion on excise taxation, as octroi taxes are

collected on various articles brought into districts for consumption, and exist to-day mainly in France, Spain, Portugal, and in some towns in Austria and in North-Western India. In Great Britain, Holland, United States, and other countries the system of octroi taxation has been universally condemned and does not exist, as it is held to impede, as Adam Smith was never tired of showing, the trade between town and county, and at the same time it imposes considerable burdens on urban industries and consumers. Not only do octrois interfere with internal trade but the cost of collection is very high. Necessity, however, knows no law, and the system has been retained in some countries on this account. In the history of early boroughs in Great Britain goods going to market or passing through boroughs paid toll, a practice which exists in certain Continental countries to-day in a decreasing degree. But the system of taxing goods in this manner does not exist in Great Britain. Article I. section 10, of the Constitution of the United States of America prescribes that "no State shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws ; and the net produce of all duties and imposts, laid by any State on imports or exports, shall be for the use of the Treasury of the United States ; and all such laws shall be subject to the revision and control of the Congress ". These octroi duties may be traced back to Roman times where cities were allowed to levy the *portorium*, a tax on the entry from or departure to a province. They were levied on wine and certain articles of food. The Romans introduced the taxes after the invasion of Gaul, and these remained after the invasion of the Franks under the name of *tonlieux* and *coutumes*. These octrois or grants were from the fourteenth century onwards granted to French towns by the king. In 1647 Cardinal Mazarin ordered that the proceeds of the octroi should be paid into the public Treasury, and at other times the Government claimed a percentage of the product. During the Revolution the octroi was abolished, owing to the abuses that had arisen, but, as the municipalities could not carry on without funds, Paris in 1798 was allowed to re-establish this form of taxation. By the law of 1809 octroi duties were allowed on (1) beverages and liquids, (2) eatables, (3) fuel, (4) forage, and (5) building materials. More than half the octrois were collected under the system of

régie simple, i.e. by means of special officers under the directions of the *maire*. The system by which a department of the Treasury collects the duties is also becoming more frequent. Farming of the duties and the system of sharing profits above a given sum with the municipality are now decreasing. From time to time proposals have been made to abolish octroi duties in France, but only half-heartedly, as in 1869. More recently France has adopted a policy of gradual suppression. In 1918 the national Government compensated the communes on the abolition of octrois on beverages from a special fund from national sources—*contributions indirectes*. In 1930 968 communes still collected octrois amounting to 964 million francs, or 11 per cent of the total local taxes of France. But in Spain octrois are still a chief source of local revenues, being next in importance to (1) the supplements to national taxes and (2) the share in national taxes. In 1871 octrois were entirely abolished in Belgium. In 1903 they were also abolished in Egypt, and in India the tendency is to do away with these taxes, terminal taxes on railways and direct taxation taking their place. They were prohibited in Holland and, as in Belgium, were replaced by direct grants to local bodies by the national Government. In Italy under the Italian tax code octrois were abolished from 1932, the national Government paying as compensation the salaries of judicial officers and school teachers, hitherto paid by local authorities. The principle underlying the abolition of octrois in these countries is the same. They are excise duties which interfere with federal or State taxation of the same character and are generally defective when collected by local authorities.

CHAPTER XXVIII

OTHER INDIRECT TAXES AND FEES

SCOPE

1. "THERE is no art", says Adam Smith, "which one Government sooner learns of another, than that of draining money from the pockets of the people."¹ In recent years miscellaneous taxes have increased in number and in productivity, and a discovery in one country of a productive indirect tax has led to its adoption in another in a surprisingly short time. The more important of these other indirect taxes and fees are stamp and registration duties, including Stock Exchange taxes and the taxation of betting and amusements. It will be remembered from the definition of direct and indirect taxation² that these are mainly examples of indirect taxes, and some of these are usually classified with excises, for example, the amusements tax. Their importance, especially in the War and in the post-armistice period, has not been inconsiderable. In India stamp duties and registration are at the present time 9·8 per cent of the total tax revenue, and in France 5·9 per cent. In South Africa the percentage is 3·4 and in Great Britain 3·2. Stamps and registration are usually grouped together, but in India and not a few other countries they are not combined. The revenue from stamps should not be confused with the revenue from postage stamps, which is usually credited to Posts and Telegraphs, a share sometimes of receipts from penny stamps being credited to stamps in view of the fact that adhesive stamps are permitted for receipts and certain other documents. Fees are levied in order to defray usually a part, in rare cases the whole, of the cost of services done

¹ *The Wealth of Nations*, Bk. V. ch. ii. part ii. appendix to articles 1 and 2 (Cannan ed. vol. ii. p. 346).

² Chapter XIII.

in the public interest and conferring some degree of advantage on the fee payer. They may be divided into judicial, commercial, and other fees. In addition to taxes referred to above, there are quasi-taxes, such as the issue of paper money which may be used either directly or indirectly as currency inflation to raise revenue. The printing of paper money is a form of enterprise which leads to disastrous effects on production. The experience of Germany in 1923 was that inflation resulted in favour of business men at the expense of those on fixed money incomes and also wage earners. It is, in short, a regressive tax. Before long the confidence of the whole community becomes lost in the future value of its currency, as was so well illustrated in the flight from the mark. A fall takes place in the internal and external value of the currency.¹

STAMP DUTIES AND FEES

2. Stamp duties include in the British tax system duties on stocks, shares, debentures, on land and property other than stocks and shares, on cheques and bills of exchange and promissory notes, on receipts, and on companies' share capital. They are the oldest of the taxes administered by the Commissioners of Inland Revenue. They differ from other taxes in that they themselves do not form separate systems of taxes but represent rather a separate method of collecting different taxes. Various taxes having no relation with one another can be collected by means of stamps. We have seen that the turnover tax in Belgium, the excise tax on cigarettes in the Union of South Africa, and the entertainment tax in some countries have nothing in common ex-

¹ Cf. "Inflation as a Method of Taxation" (ch. ii. Keynes's *Tract on Monetary Reform*, Macmillan, 1923). It is to be noted that "the burden of the tax is well spread, cannot be evaded, costs nothing to collect, and falls, in a rough sort of way, in proportion to the wealth of the victim. No wonder its superficial advantages have attracted Ministers of Finance. . . . What is raised by printing notes is just as much taken from the public as is a beer duty or an income tax. What a Government spends the public pay for. There is no such thing as an uncovered deficit. But in some countries it seems possible to please and content the public, for a time at least, by giving them, in return for the taxes they pay, finely engraved acknowledgements on water-marked paper. The income-tax receipts, which we in England receive from the Surveyor, we throw into the wastepaper basket; in Germany they call them bank notes and put them into their pocket-books; in France they are termed Rentes and are locked up in the family safe" (*op. cit.* pp. 43 and 62). This referred to postwar inflations about the time when the author referred to wrote his Tract. The underlying principle is important.

cept that they are collected by means of stamps. Stamp duties are paid by means of adhesive revenue of the required value affixed to the document or by means of embossed or impressed stamps. They may conveniently be classed under two heads—judicial and non-judicial. The former are more in the nature of fees by which a return is received by the payer in the form of services rendered by the Courts or otherwise. In the case of non-judicial stamp duties stamps are affixed on written documents which are evidence of the legal rights involved. No direct return is received, and as such it is possible in certain cases for the parties to evade the tax as in the case of the duty on receipts in the British system. From 1783 to 1853 there was a graduated duty on receipts. Mr. Gladstone introduced the fixed penny duty and the repeal resulted in a larger yield. The tax until that date was very inconvenient and had been evaded to a very large degree. Similarly in India. In the case of a sale deed for Rs.1100 the parties might make a formal agreement for Rs.1000 thus paying Rs.10 as the stamp duty, and the excess amount of Rs.100 may be paid by the buyer without mentioning it in the deed, and thus saving Rs.5 on duty as Rs.15 would have to be paid for Rs.1100. Receipts too are frequently given without the affixing of stamps. In some cases the parties cannot dispense with the written evidence as, for example, in the case of insurance policies. It should, however, be remembered that the affixing of the necessary stamps to the document does not warrant its legality ; it merely makes it possible for the legality to be examined. Sometimes the dutiable instruments are classified into three groups : (1) Instruments denoting the creation of contractual rights such as bills of exchange and contracts in regard to insurance ; (2) Instruments denoting the transfer of property or the creation of rights in property, such as mortgage deeds and the transfer of securities ; (3) Instruments denoting the grant of privileges, such as grants of peerage and knighthoods.

The incidence of the tax depends on the object of the transaction which is taxed. Stamp duties have been condemned by economists on the ground that they often fall on the wrong person and are not capable of being graduated according to ability. Adam Smith spoke of the taxes on the transfer of property as “more or less unthrifty taxes”. “Such taxes”, he adds, “even when they are proportioned to the value of the property transferred are still unequal ; the frequency of transference not

being always equal in property of equal value." He realised that they were not arbitrary but perfectly clear and certain. Mill objected to the tax on the purchase and sale of land which always fell upon a seller who was obliged to sell it for reasons of convenience or necessity, and they were "cruel and oppressive". The conveyance duty adds to the expense of company formation where large assets are taken over. An administrative concession in Great Britain is granted where a reconstructed company is formed to take over the existing company, and where the shares in the new company are the same, the shareholders hold shares and in the same proportion as those in the existing company. The incidence of the duty on the conveyance of land cannot be laid down with precision, because when this tax is imposed and the first sale takes place the purchaser will be inclined to give a lower price for the property. It tends, in so far as it is a recurrent liability, to fall on landowners. As the Colwyn Committee on National Debt and Taxation¹ rightly points out, "All that can be said is that the original owner may tend to suffer most; in land and house property, however, the exact price is so largely fixed by individual powers of bargaining that it is impossible to determine how far it has been affected by the duty, or, in other words, what proportion of the duty has really been borne by either party." The incidence of the duty on bearer bonds, which are far more common on the Continent than in Great Britain, appears normally to be on the borrower. The lender is not willing to take the burden of the duty on himself. It has been pointed out as between the United States and Great Britain that in the flotation of loans there is a great advantage in regard to stamp duties in the case of the United States, and that this works on account of the tax to the advantage to the United States, and emphasis has been laid upon the value of foreign loans as a stimulant of exports. The small amount of the duty, however, is not likely to have the effect of turning away business, and there is no evidence in the London money market that it has had this effect. There are other factors which count far more, such as the ability of the market to be able to digest the loan. The Colwyn Committee quoted Mr. A. M. Samuel, who said, "Whether harm arises in present circumstances from the loss of such business is

¹ Report of the Colwyn Committee on National Debt and Taxation (Cmd. 2800, 1927, p. 201).

doubtful. Some of the foreign loans alleged to have been driven away from London by high stamp duties were floated in New York. But it is said that New York failed to digest the loans and that London bought the loans in New York, and brought them to London at a cheaper rate than that at which they would have been issued in London.” The companies’ capital duty tends to fall on the company. It is not passed on in prices to the consumer. Since the duty is a charge on profits the effect falls on the shareholders. The duty on cheques falls on the person drawing the cheque, and is always borne by him unless it can be passed on in some business transaction. The trader is said to pass the duty on to the consumer because it enters into the costs of all traders. The effect of a reduction in the stamp duty on cheques is often exaggerated. It has been argued that the 2d. stamp duty in Great Britain makes people draw cheques for larger sums than they did before the duty was increased. This may be due to the higher prices which have to be paid for most things. The Colwyn Committee¹ summarised the view generally held on stamp duties thus : “The stamp duties are a cause of occasional irritation to the citizen and of some recurrent friction in business, and particularly in finance. While they are open to many objections, they do not seem in practice to meet with much opposition from the general taxpayer and they may be held to illustrate the saying that ‘an old tax is a good tax’. Nevertheless, in relation to their moderate yield, we are disposed to think them one of the less satisfactory parts of the British tax system.” In France, where business is subject to much greater taxation than in Great Britain, there are many stamp duties of this nature, such as those on subscriptions to French and foreign securities, foreign securities not held under subscription agreements, and stock and commodity exchanges. The psychology of the French and indeed of the German taxpayer is different from that of the English, and these taxes cannot be said to be regarded with disfavour. English writers, however, such as Hobson in his *Taxation of the New State*,² regard stamp duties as a “ restraint on trade and other forms of presumable personal and social utility. They are in their final incidence at the best nothing but an expensive way of tapping certain bits of income which, if left untouched, would

¹ Report of the Colwyn Committee on National Debt and Taxation (Cmd. 2800, 1927).

² *Taxation in the New State*, p. 125.

yield their quota to ordinary direct taxation, while at their worst they are extortions from persons who possess no real ability to pay. For the most part, they are the cumbersome relics of a past haphazard method of 'catchpenny improvisation, which has no place in any scientific system of finance.' A more correct view is that already stated that, "an old tax is a good tax".¹

3. The tax on stamps was introduced from Holland into Great Britain in 1694. Seventy years previously the tax had been discovered in Holland by a private individual in response to a proclamation of the States-General offering a prize for the invention of a new tax. The duty was first of all a duty on paper or parchment which was presented at the Government Stamp Office for stamping. There were six different stamps, one of 40s. as a payment for royal grants of land and presentations to ecclesiastical benefices. There were five smaller stamps of 5s., $2\frac{1}{2}$ s., 1s., 6d., and 1d., for numerous other legal instruments specified in the Act.² The charges were thus fixed according to the class of instrument, and to a certain extent were a tax on the amount of paper used. In 1797 the *ad valorem* principle was introduced except for property. Until 1808 the tax varied mainly according to the length of the document in the case of property. By 1815 *ad valorem* duties became general but the scales were arbitrary, with maximum charges for transactions over a specified limit. In 1850 percentage duties were introduced on bonds, conveyances, mortgages, and settlements. In 1853 a penny was fixed as the postage on receipts in place of the varying rate according to value, namely, 3d. to 10d., and ordinary stamps might be used for this purpose. In 1891 the Consolidating Stamp Act, the basis of the present stamp legislation, was passed, and it provided for an *ad valorem* duty on (1) transactions regarding property, bills of exchange and promissory notes ; (2) penny duties on receipts, cheques, etc. ; and (3) fixed duties on deeds and instruments not mentioned above. This Consolidating Act prescribed penalties such as £10 for the non-receipt of a document and the making void of any agreement not stamped. It is also the duty of the judicial officers to take notice of the absence or insufficiency of duty when an instrument is tendered before him in evidence. Moreover a person duly

¹ John Stuart Mill seems to think that if a tax goes on long enough it ceases to be a tax at all.

² 5 & 6 William and Mary, c. 21.

appointed to enrol or record a document is liable to fine if he enrols or records the instrument insufficiently stamped. At the present time the receipt for £2 or upwards is 2 pence, the penalty for not stamping is £10.

It will be seen that some duties are charged on documents and writings having a legal operation or forming necessary steps in law-suits. These duties are collected by means of stamps impressed on or affixed to the instruments. In addition to these there are duties on commercial documents, such as bills of exchange and contract notes, companies' capital duty (which amounts to £1 on every £100 of the nominal capital of companies or corporations with limited liability and 2s. 6d. on loan issues by local authorities, companies, and corporations on every £100 secured), insurance, drafts, and receipts. Under the Stamp Act of 1891, postage adhesive stamps, it may be noted, are permitted for bills of exchange, including cheques, for payment of money on demand, certified copies or extracts from registers of births, charter parties, leases of dwelling-houses not exceeding a year at a rental not exceeding the rate of £10 per annum, or of any furnished dwelling-houses for any definite term less than a year where the rent for such term does not exceed £10, receipts, policies of insurance (not life nor marine), proxies, and voting-papers. In the United Kingdom most of the stamp duties are from deeds, the amount of revenue being 48 per cent of the total stamp duties in 1929–30. Receipts amounted to 11 per cent, companies' capital duty to 15 per cent, bills of exchange to 19 per cent, insurance to 4 per cent, and others to 3 per cent. The fee stamps proper include judicature fee stamps, land registration fees, and other fee stamps for companies' registration, district audit, civil services commission, and registered houses (Scotland). It is interesting to notice that these stamp duties reflect frequently the state of trade of the country. In Great Britain, for example, in 1921–22, as compared with the previous year, there was a decline from £27 millions to £20 millions in stamp duties, of which decrease £2½ millions were on account of conveyances. There were also decreases in the receipts from cheque stamps, bills of lading, and shipping policies owing to the trade depression of the year. In some countries stamp duties have not been changed for long periods, notwithstanding a considerable change in the level of prices and in the cost of the judiciary. Financial pressure, and also economic changes,

especially of prices, of a more or less permanent nature, have in some countries produced a revision. Nevertheless there are some who hold that stamps for judicial acts, unlike those for ordinary commercial instruments, should not be raised unduly. In a well-known passage Jeremy Bentham writes of " attacks upon security committed through ignorance, inadvertence, or false reasons ", and he includes among them taxes upon law proceedings. He says that " they include all kinds of attacks upon security, since they are equivalent to refusing the protection of the law to all those who cannot pay for it. They consequently offer a hope of impunity to crime. It is only necessary to choose as objects of injustice individuals who cannot afford the advances necessary to a judicial prosecution, or who are not rich enough to run the risk ".¹ This reminds one of the well-known saying in the Santi Parvam of the *Mahabharata* that " the king should act like the leech taking blood mildly. He should treat his subjects like a tigress carrying her cubs, touching them with her teeth, but never cutting them therewith ".² A tax on legal process may be a hindrance to the use of the courts, but it must be remembered that taxation of Acts is a subordinate one in the tax system of most modern countries.

In imposing stamp duties it is necessary to see that they should not be so excessive as to retard business or to cause evasion. If the duty on receipts, for example, is very high the payer may rely on the credit of the payee and the payment of the duty required by law may be evaded. It has generally been agreed that the rates of stamp duty should be fixed in accordance with : (1) The point at which the value of the convenience or utility attaching to the use of a particular kind of document or resort to a particular kind of transaction approaches the amount of the stamp duty involved ; (2) The point of diminishing returns, or, in other words, what the traffic will bear ; (3) The point at which hardship on any class of the community is involved.

TAXATION OF BETTING

4. Another group of indirect taxes includes those concerned with lotteries and betting. In the past States raised money

¹ Bentham, *Theory of Legislation*, p. 140 (London, Trubner & Co.).

² Chapters lxxxviii. and cxxix. Santi Parvam.

through the taxation of lotteries, and even built churches with the proceeds. St. John's Cathedral in Calcutta was the result of this, and not a few town halls owe their origin to this form of taxation. To-day Governments, such as the Government of Italy, are controlling such forms of gambling by means of taxation. In connection with public loans, a reference will be made to State lotteries, especially those which prevailed in England between 1694 and 1826. Here we are concerned with the taxation of private lotteries and not with State lottery loans. Lotteries like the well-known Calcutta Sweepstake, which frequently awarded prizes of over £50,000, certainly are fit subjects for taxation, just as the taxation of betting. The attitude towards the taxation of betting has changed remarkably in recent years, especially in the self-governing Dominions. It is realised that, although betting may be a fool's game, still taxation is both practicable and desirable. By no twist of the imagination can it be held that by being taxed and made lawful betting will be further encouraged. As in the case of drink, it is somewhat likely to be checked than further promoted by regulation, and certainly taxation would diminish the malpractices associated with it. A wrong thing is not encouraged by diminishing the money profits from its practice. The real question before the financier, and indeed the only question, is whether the probable contribution to the Budget is sufficiently substantial to make the tax worth while. The gambler on the Stock Exchange contributes in many countries by stamps on his contracts his share of taxation to the State. Stock Exchange transactions are taxed only when States see that it is worth their while. The taxation of betting, although in the nature of luxury taxation, does not deserve to be included under the group fancy taxes. An ex-Lord Chancellor, speaking in the House of Lords in March 1924, remarked that "to say it was a shocking thing to legalise betting was merely to show the depths of hypocrisy in which we were living in regard to matters of this kind. Was it not legalising betting to charge income tax upon the bookmakers' profits, or for the Post Office to say they held themselves in readiness to transfer the bets from the man who made them to the man who had the office for betting ? The whole argument was the most arrant hypocrisy." The method of effecting the taxation of horse-racing, football, and similar matches, where betting does take place, has been thought

out carefully, especially in Australia. The Federal Government collects a tax on tickets for admission, except those issued at a very low figure. This, however, belongs to an amusement tax. The state Governments levy a tax on betting tickets which are stamped, the highest stamp being usually 3d. in New South Wales and Victoria, the rates of tax being lower in suburban areas. The tax department issues the tickets already stamped, so that the bookmaker wanting any number can have them on application. In New South Wales the practice is for the bookmaker to send his tickets, already printed, to the stamp office, and to have them stamped by Government agency. In Victoria Government prints the tickets to safeguard against fraud, and the tickets are numbered. In addition to a tax on betting-tickets, there is a special tax levied as a licence on bookmakers, amounting to a maximum of £50 in Victoria and £70 in New South Wales. In addition to these there is a tax on the totalisator betting. In New South Wales racecourse betting with the totalisator reached over £600,000 in 1921-22. If it be remembered that the population of the state is two millions and that the highest tax is 3d., an idea can be formed of how productive such a tax can be. In Great Britain a considered scheme was put forward by the Board of Customs and Excise, and published in 1924 in the Report of the Select Committee appointed to consider the question of imposing a duty on betting.¹ This scheme proposed not only to register and license all bookmakers and their premises, and lay the responsibility for paying the duty on the bookmakers, but to legalise ready-money betting and place $2\frac{1}{2}$ per cent duty on all amounts staked as bets. The details of the scheme were as follows : (1) to levy an *ad valorem* duty on all the amounts staked as bets with professional bookmakers, the bookmaker to be responsible for the payment of the duty, and heavy penalties to be imposed on bookmakers acting without a licence ; (2) to make cash betting off racecourses legal on condition that it takes place in registered betting-houses, all betting-houses, even those where credit betting only is carried on, to be registered ; (3) the amount of duty charged for registration of a betting-office to be £20 annually, and the machinery for the collection of the tax to be on the model of that of excise, which would require the licensing of bookmakers and the registration of their premises. The

¹ No. 139.

method of collecting the duty was to be as follows : " For ready-money betting the Government would issue at the Post Office and at the Board of Customs and Excise, and on racecourses books of tickets containing a number on which the duty amounts to a round sum. For example, a book would contain say 100 tickets for 1s. bets at a cost of 2s. 6d. (*i.e.* $2\frac{1}{2}$ per cent on £5), or 100 tickets for 2s. bets at the cost of 5s. (*i.e.* $2\frac{1}{2}$ per cent on £10). Similarly a book of 50 tickets for £1 bets would cost 25s. or $2\frac{1}{2}$ per cent on £50. The tickets would be differently coloured for each denomination of bet, numbered consecutively, and stamped or not, as thought desirable. The bookmaker would issue to the backer a ticket for the amount staked. Thus the tax would be collected automatically. In the case of credit betting the Board of Customs and Excise would arrange to collect from the bookmaker the tax due. as shown by his books on weekly or monthly returns, if he was in a position to give adequate security to the Crown for payment of the duty. Failing this, a Government ticket would have to be given for each credit bet : in practice this would hardly ever occur." Strong provisions to prevent evasion of the taxation or fraud were to be inserted in the Act. The cancellation of registration would be the strongest protection for the revenue in the case of office bookmakers, and forfeiture of licence in the case of evasion by racecourse bookmakers.

The betting tax was first levied in Great Britain in 1926. According to the Act an annual duty of £10 was imposed on the registration of each set of premises used by a bookmaker for receiving bets on credit, and a duty of the same amount was charged for certificates required to be taken out by the bookmakers. Relief was granted in respect of bets laid off or made void for any reason. On and after 1st November 1926 betting duty was payable on every bet made with a bookmaker at a rate of $3\frac{1}{2}$ per cent of the amount staked. The rate was 2 per cent in the case of horse-racing bets. A revenue ticket denoting that the duty has been paid was to be issued by the bookmaker to the backer at the time of making bets. This could be dispensed with by the bookmakers by arranging with the Commissioners of Inland Revenue to furnish returns of bets made with him. The rates were reduced to 2 per cent and 1 per cent respectively by the Finance Act of 1928. These duties, including the annual duty of £10 on entry certificates were repeated, and in its place a duty of

£40 on each telephone used by the bookmaker and $\frac{1}{2}$ per cent duty on stakes laid with a totalisator. The receipts from this source for the year 1930-31 amounted to £16,000.

A betting tax has been levied in Bengal since 1932 under the Schedules Taxes Rules. The tax is levied at the rate of 4 per cent on all money paid into the totalisator and money paid by licensed bookmakers to winning backers. The tax yielded in 1929-30 Rs.1,200,000 or a little more than 1 per cent of the tax revenue of the province. The totalisator tax is levied in Bombay. Recently Burma has adopted the tax. The tax is capable of further extension in the various provinces of India. In sixteen states of the American Union there are licences or pari-mutuel taxes with regard to race meetings, and in twelve both licences and pari-mutuel taxes are levied. The licence takes the form of a fixed amount per diem which varies with the importance of the tract, and the usual rate of tax is from 3 to 5 per cent of the gross receipts of pari-mutuels. These taxes exclude the admissions tax. In Germany under the Betting and Lotteries law horse-racing and the raffling of lottery tickets are taxed on the basis of the amount of the stake and the price of the lottery tickets respectively. The rate of tax on the totalisator is $16\frac{2}{3}$ per cent and on the bookmaker $16\frac{2}{3}$ per cent. In the case of German lotteries the tax is 20 per cent of the price of tickets exclusive of tax, and in the case of foreign lotteries 0.25 reichmark on every gold mark. Four per cent is retained by the national Government for the costs of administration and 96 per cent is returned to the states. The totalisator tax is determined according to the location of the totalisator, and the whole amount must be used in favour of unions for the improvement of horse-breeding. The distribution of the bookmaker's tax is that the distribution between the states is $\frac{2}{3}$ by the location of the tax collection and $\frac{1}{3}$ by population. The whole of the lottery tax is retained by the national Government.

TAXATION OF AMUSEMENTS

5. The taxation of amusements has in recent years become popular in many countries. In Australia the legislation is federal and provincial, there being provincial acts in Victoria, New South Wales, West Australia, Tasmania, and South Australia. In Tasmania the whole of the tax leviable under the Common-

wealth and Tasmania Acts is collected by the Commonwealth, the central Government handing over to the state Government without any deduction for the expenditure of collection the portion belonging to the state. In consideration of this, the services of the state police in the way of supervision are given free of charge.¹ In Canada several provinces levy this tax on admissions to places of entertainment. Thus in Ontario it varies from 2 cents to 25 cents depending on the price of admission and the kind of entertainment. In India two Governments only, those of Bombay and Bengal, introduced the tax. There is no tax imposed by the central Government. In Germany the tax is a State tax. It varies, for example, in Prussia from 10 to 25 per cent of the prices for admission. In most countries the rate is based on the price for admission. In some countries, as in England from 1935, there is a differential rate depending on the nature of the entertainment. In Italy the rate is 10 per cent for theatrical performances, 10 to 20 per cent on cinemas, 15 per cent on sports, and 20 per cent on horse-racing. The amusements tax, like other expenditure taxes, was introduced at a time when it was necessary to levy as much taxation as possible on all forms of luxury expenditure and to encouraging saving. The War, however, showed that a tax on luxury, unlike that on tobacco and spirits, which are conventional necessities, cannot always be looked on as a productive source of revenue. There are taxes, however, such as the amusements tax, which fall ultimately on those who indulge in certain forms of amusement, and yields large amounts of revenue. Some countries regard the tax as a non-permanent tax, while others regard it as a permanent or quasi-permanent part of the tax system. In 1921 the House of Representatives of the Commonwealth of Australia repealed the Act, but it was defeated in the Senate. Questions have been asked in the British House of Commons regarding the repeal of the Act in Great Britain, but the Act still continues. The Royal Commission on Taxation in Australia² recommended that it was somewhat in the nature of emergency legislation, and its repeal should be considered when the state of public finance rendered such a course possible. There is much to be said in favour of the tax where it is productive. In Great Britain in 1933-34 it

¹ Section 5A of the Amusements Duties Amendment Act, 1917.

² F 18112, 5th and final Report, 1923.

was 1·3 per cent of the total tax revenue, bringing in £9 millions, and in Australia the federal tax was 0·3 per cent of the federal tax revenue, bringing in £133,000. In recent years the entertainments tax has risen by leaps and bounds owing to the cinema craze. For example, in 1930 the entertainment tax in Great Britain was £6,695,847, and in spite of the greatest trade depression ever experienced the tax for the year ending 31st March 1934 was £9,235,160. Its effects have not been deleterious, although conditions have not been sufficiently normal to consider such effects in detail. The main objections against amusements or entertainments taxes are that they are unequal because certain amusements only are taxed. It might also be said that the tax discourages amusement or recreation, which is essential for the well-being of the community. The important points in the taxation of amusements centre mainly round the definition of amusements or entertainments and also the meaning of "payment for admission", "proprietor", etc. In most countries entertainment includes any exhibition, performance, lecture, amusement, game, or sport for admission to which payment is made. Exemptions are usually allowed in cases where the whole of the proceeds are devoted to philanthropic, religious, or charitable purposes without any charge of the proceeds for any expenses. Entertainments of a wholly educational character or only for the amusement of children, or partly educational and partly scientific by a society, institution, or committee not conducted for profit, are exempted. In Australia the taxing of payments for articles supplied by the proprietor for the purpose of an entertainment, such as skates, are to be included in the "payment for admission". The rates of tax are progressive. In Great Britain an entertainments duty came into force from 15th May 1916. The rates as fixed by the Finance Act of 1919 varied from a halfpenny on payments of 2½d. and below to 2 shillings for the first 15 shillings, and 6d. for every 5 shillings or part of 5 shillings over 15 shillings. In the Budget for 1924–25 the duty was repealed on tickets up to the value of 6d., and reduced on tickets from 7d. to 1s. 3d. This repeal and reduction cost £4,000,000 in a full year. The Emergency Budget of 1931 reimposed the duty on admission for payments over 2d. up to 6d. (which had been free from 1924). It also increased the scale of payments over 6d. In imposing these extra charges in 1931 the Chancellor of the Exchequer expressly stated that he desired to

give an opportunity to all sections of the community to contribute towards the nation's need. The tax, however, seemed to fall largely on the proprietors rather than on the public. With effect from 1st July 1935 all payments up to 6d. were relieved of the duty. This costs £2,300,000 in a full year. A differential rate in the duty of seats over 6d. was also made in favour of those entertainments in which living performers take part. In the United States there is an admissions tax levied by the Federal Government on admissions in excess of 40 cents except for admission to places specifically exempted. The tax is 1 per cent on each 10 cents or fraction thereof. In addition certain states, twenty-three in number, levy a tax on public amusements mainly for boxing and wrestling contests, which usually vary from 5 to 10 per cent of the gross receipts. The states of Arizona, Connecticut, Mississippi, North Carolina, West Virginia, Utah, Washington, and Wyoming tax theatres including motion pictures. In the Australian legislation the Commissioner is given extensive powers, which he can delegate. The penalties for evasion vary from £5 in the case of a person admitted to £50 in the case of a proprietor guilty of an offence. Certain offences are indictable, such as forging a die or stamp, fraudulently mutilating any stamp with the intent that any use may be made of any part of the stamp, and the maximum penalty is 14 years' imprisonment. Other offences involve the liability to imprisonment for 7 years, 3 years, and 1 year. A sum of £50 is fixed as the maximum penalty for any breach of the regulations. It will be seen, therefore, that, if proper steps are taken to prevent evasion, the tax is a good luxury tax and one that is not troublesome to collect. In some places complaints have been made, as in Australia, that there has been delay in obtaining registration under the Commonwealth Act in remote districts. This difficulty has been surmounted by a system of registration to be made with local postmasters.

CHAPTER XXIX

THE BURDEN OF TAXATION

1. THE burden of taxation is a problem which faces the student of finance from more than one point of view. In the first place, it may be necessary to compare the relative total burden of taxation in the same country at different periods. Secondly, it may be desirable to compare the relative burdens of direct and indirect taxation in the same country at the same time and at different times. Thirdly, the problem may be to compare the relative burden of taxation at any period in one country with another. All these questions raise many important problems regarding the weight of taxation. In Chapter XV. the calculation of national income and of taxable capacity has been examined. It was shown that in recent years the methodology of national income had been examined by economists and statisticians in various countries, and there was now an international attempt to secure uniformity of definition and to show for various countries the component parts of national income so that in making comparisons of the income in various countries comparable items alone would be taken into account. In that chapter, too, the essentials of the concept of taxable capacity were examined. The purpose of this chapter is to examine a little further the problem of the pressure of existing taxation direct and indirect with some broad considerations and conclusions regarding this question.

The burden of taxation is an ambiguous term and, like many other economic terms used in popular discussion, its meaning is not always clear. We sometimes mean the payment burden of the tax and sometimes the total or sacrifice burden in which this payment burden is included. Thus in foreign trade we sometimes speak of the burden of a heavy protective import duty on the foreigner. We multiply the unit burden of the tax by the number

of units imported, and we say that is the burden imposed on him. But the burden may be a much larger burden involving a greater sacrifice than this because the foreigner may not be able to export to the country levying the tax the same amount of goods as formerly. And here the elasticity in the demand for the article plays an important part in regard to the total or sacrifice burden. Then again we speak of the burden of income tax, and it is sometimes said that this burden is heavy because it does not take account sufficiently of the ability of the individual taxpayer as so much depends on the circumstances of the individual, his family responsibilities, and so on. It presses hard on small incomes, particularly of the professional classes. We sometimes hear of the burden of taxation hampering progress as heavy taxation is said to deaden enterprise, to impede the growth of reserves, and thus to reduce productivity. It is said to discourage saving and thus to reduce the accumulation of capital which is necessary for further production in a community. If the burden is very great there is the tendency for individuals to spend freely because owing to the taxation it is not worth while to save. Business enterprise with high rates and taxes may be such as to effect competition in world markets. An ex-Chancellor of the British Exchequer (Sir Robert Horne) in criticising the Budget of 1924–25 pointed out that whereas in pre-War days rates and taxes added 2s. 9d. per ton to the cost of finished steel, it added in 1924–25 21s. 4d., with the result that competitors could undersell English manufacturers to the extent of 30s. to 40s. per ton. It has also been alleged that the burden of taxation on higher incomes is so great that it affects the entrepreneur class and the capitalist. The capital which is waiting for an opportunity for investment in some new productive enterprise in a modern industrial community is in the hands of relatively few people who are always ready to take risks in the early stages of an enterprise and, if the State by taxation takes away a great part of this capital, production suffers and the rich men who could afford to take these risks by using their surplus incomes and who are always on the alert for productive opportunity find the burden of taxation so crushing that they are forced out of existence. The State by the heavy burden of taxation thus brings about a lack of the spirit of enterprise, and it is enterprise which builds up the commerce and industry of nations. In short, an examination of the burdens of taxation is important since any

overburdening of the taxpayer generally, or of one class of taxpayers at the expense of another, may have a bad effect on a country. It is for these reasons that the burden of taxation today is a problem that deserves very careful examination.

2. Taxation thus lessens the resources in the hands of private individuals and transfers to public authorities the proceeds to be expended on different services. The idea of burden arises from the fact that (1) there is no direct connection visible between the amount contributed in taxation and the services received by the individual. There is the absence of a *quid pro quo*; (2) taxation is compulsory, and is therefore felt as a burden; (3) funds are taken by public authorities which would otherwise have been used for private consumption or private saving. The creation of new work and new capital is thus penalised. Heavy taxation in the form of heavy death duties, income tax, or other forms of taxation prevent potential new capital from coming into being. This raises a further question as to the extent to which this new capital is desirable or not in the circumstances of any given year, or on the other hand whether the State should retain at least its present level of taxation. There may be already excessive saving, the result of a too rapid growth of thrift among all sections of the population, and the economic machine may not have adjusted itself. In England in 1935, for example, there was not an urgent need for new capital when hundreds of millions of pounds were lying idle and every suitable issue was heavily over-subscribed. States may spend, as on the social services, money more judiciously than the private individual if the money were left in his pocket, but often the money is spent by the States on wars and on armed peace; (4) with the development of States, taxation has enormously increased, as the king could not, as in early times, live on his own resources. After great wars taxation has increased so rapidly that its weight is all the more felt. In this chapter we are concerned more with the individual burden than the social burden of taxation. In order to discuss fully the social burden it would be necessary to analyse the method in which the various countries spend their tax revenue on social services and on other heads of expenditure. To this a reference has already been made in the chapter and the tables on the distribution of expenditure.

The real burden of taxation in its relation to national income

has received considerable importance in the present century, especially since the War, by many writers on public finance. An investigation of national income has been made in most countries.¹ Taxation is, as has been shown, the transfer of a part of a taxpayer's spending and saving power to public authorities, and the burden of this varies with the income of the individual and of the nation as a whole. The State takes from its citizens certain sums which it disburses in wages, salaries, materials, and social services. It is important to test the progress in the same country at different periods and to test the prosperity between different countries at the same period, and also to study the yield of certain schemes of taxation by an examination of all the facts. In the Treaty of Versailles it was provided that the Reparations Commission should periodically estimate Germany's capacity to pay, and that the German scheme of taxation should be "fully as heavy proportionately as that of any of the Powers represented on the Commission".² The First Committee of Experts appointed by the Reparations Commission explained in their Report that "the comparison of statistics of total taxation, national and local, in each country presents many technical difficulties. Moreover, statistics of total national income and income per head are at present either very defective or wholly lacking. Notwithstanding these difficulties it is possible to compute roughly what total budget charge would be borne by the German people if they were subject to taxation (central and local) on the same scale per unit of income as in Great Britain, and by deducting from the result the necessary domestic expenditure to derive an arithmetical balance which could be, theoretically, at any rate, assigned to the payment of reparation."³ The Committee gave no statistics. In Great Britain

¹ See Chap. XV. of this work. Cf. Stamp on National Income, *Journ. Royal Statistical Society* (London, 1934).

² Annex 12 B, Treaty of Peace. The First Committee of Experts on German Reparations, presided over by General Dawes, stipulated that Germany should pay for 1929-30 and following years a sum in addition to the standard payment according to the prosperity of Germany. To measure this prosperity various factors, such as the total of German imports and exports, the total of budget receipts and expenditure taken together (after deducting from both sides the amount of the Peace Treaty payments included in the year), railroad traffic as measured by the statistics of weight carried, the total money value of the consumption of sugar, tobacco, beer, and alcohol within Germany, the total population of Germany, and the consumption of coal *per capita*, were to be taken into account.

³ Cmd. 2105, p. 48. For considerations regarding the measurement of Germany's burden, cf. Cmd. 3343—1929.

the Chancellor of the Exchequer appointed in March 1924 a committee of 13 under Lord Colwyn "to consider and report on the national debt and on the incidence of existing taxation, with special reference to their effect on trade, industry, employment, and national credit". This Committee calculated the burden of taxation direct and indirect on various incomes for the years 1903–4, 1913–14, 1918–19, 1923–24, and 1925–26, following the lines of the President (Sir Herbert Samuel) of the Royal Statistical Society in his Presidential address¹ in 1919 on "The Taxation of the various Classes of People". The figures were for a taxpayer assumed to be married and to have a wife and three children. Although the size of an English family for all marriages is about $1\frac{1}{4}$ and $2\frac{1}{4}$ if married couples without children are excluded, three children were taken in order to make allowances for relatives or dependents who while frequently earning independent incomes may add to the total burden of the household. Stamp duties were excluded as these could not be allocated with any accuracy according to the size of income, and they have no clearly definable relation to the annual income of the individual. The tax payable on various selected incomes for direct taxes such as the income tax and death duties, and on indirect taxes such as customs and excise duties, including tobacco, alcoholic drinks, and entertainments, were carefully worked out. The figures of income tax presented no difficulty as they were readily available. In the case of death duties the burden was converted into an annual life insurance charge, as an approximate indication of the amount likely to be due, other things being equal. The burden of customs and excise duties was calculated from official and non-official sources such as the budgets of household expenditure used by the Board of Trade and from calculations of the total consumption of alcoholic drinks made by Rowntree and Sherwell in their book *The Temperance Problem and Social Reform*, which extended to 10,000 households. The investigations in this enquiry were continued by Sir Bernard Mallet and Sir Herbert Samuel, and supplemented by the Colwyn Committee's own investigations. The Committee² in allocating the different levels of income under the entertainments duty acknowledged there was a good deal of conjecture, but figures were

¹ *Journal of the Royal Statistical Society*, London, 1919.

² Report of the Colwyn Committee on National Debt and Taxation. Cmd. 2800—1927, pages 94–96.

given for selected incomes and the duty paid on these incomes. Some of the results are summarised in the following table :

THE BURDEN OF TAXATION ON BRITISH INCOMES, £150, £500, £1000, AND £2000,
IN THE PRE-WAR YEAR 1913-14 AS COMPARED WITH A DECADE BEFORE THE
WAR (1903-4) AND A DECADE AFTER THE WAR (1923-24).

Income £150						
	Pre-War Year (1913-14)			10 Years before (1903-4)		10 Years after (1923-24)
	£	s.	d.	£	s.	d.
Total Direct Taxes ¹	.	.	.	0	4	6
„ Indirect ²	.	.	.	6	4	8
				6	8	6
„ Taxation	.	.	.	6	9	2
				6	13	0
Percentage of Total Tax:						
Direct	.	.	.	0·2		0·2
Indirect	.	.	.	4·2		4·3
				4·4		4·5
Total	.	.	.	4·4		4·5
						13·5
Income £500						
	£	s.	d.	£	s.	d.
Total Direct Taxes	.	.	.	13	5	0
„ Indirect	.	.	.	8	15	10
				8	17	0
„ Taxation	.	.	.	22	0	10
				26	2	10
Percentage of Total Tax:						
Direct	.	.	.	2·6		3·5
Indirect	.	.	.	1·8		1·8
				4·4		5·3
Total	.	.	.	4·4		5·3
						8
Income £1000						
	£	s.	d.	£	s.	d.
Total Direct Taxes	.	.	.	40	10	0
„ Indirect	.	.	.	11	10	10
				11	15	0
„ Taxation	.	.	.	52	0	10
				60	11	8
Percentage of Total Tax:						
Direct	.	.	.	4·0		4·9
Indirect	.	.	.	1·2		1·2
				5·2		6·1
Total	.	.	.	5·2		6·1
						14·1

¹ Direct Taxation : (1) Income tax (wholly earned) super-tax ; (2) death duties ; and for 1903-4 and 1913-14 inhabited house duty, the tax being abolished by the Finance Act, 1924.

² Indirect Taxation : Taxes on tea, sugar, tobacco, alcoholic drinks, entertainments, cocoa, coffee and chicory, dried fruits, patent medicines, and table waters.

<i>Income £2000</i>			
	Pre-War Year (1913-14)	10 Years before (1903-4)	10 Years after (1923-24)
	£ s. d.	£ s. d.	£ s. d.
Total Direct Taxes	79 15 0	96 8 4	313 11 3
,, Indirect	18 0 10	18 13 0	43 8 6
,, Taxation	97 15 10	115 1 4	356 19 9
Percentage of Total Tax :			
Direct	4·0	4·8	15·7
Indirect	0·9	0·9	2·2
Total	<u>4 9</u>	<u>5·7</u>	<u>17·9</u>

The Committee did not make comparisons with other countries, although they were interested in comparative burdens in regard to the burden of taxation in less heavily taxed countries with especial reference to the effects of such taxation on British industry. Nevertheless, the Committee concluded that "It may be said definitely that the burden of taxation was heavier in Great Britain than in any other European country, and very much heavier than in the United States". They were not prepared to show this statistically, although in coming to this conclusion they must have had access to measured data. In India the Taxation Committee appointed "to examine the manner in which the burden of taxation was distributed between the different classes of the population, and to consider among other matters whether the whole scheme of taxation, central, provincial and local, is equitable and in accordance with economic principles, and if not in what respects it is defective".¹ It showed less courage than the Colwyn Committee even in estimating the burden of taxation in India at the time of their inquiry, and they did not give comparative international tax burdens. Nevertheless they did use statistics such as those on the weight of the salt tax, customs duties, excise duties on alcohol and municipal taxes, and from this data and other sources estimated in general times the burden of taxation on the urban labourer, the landless agricultural labourer, the small and the large landholder, the village trader, the small trader in towns, the large trader, the big merchant, and the lower and higher grades of the professional classes. Indeed the Committee, although not publishing the data by which they arrived at their conclusions, made recommendations such as the

¹ *Vide Report, ch. xiv.: Calcutta (Govt. of India, Central Publication Branch), 1926.*

benefits that would result from a decrease in customs duties and in municipal taxation in the case of the urban labourer, and that there should be no decrease on the salt tax or on the excise on alcohol which he pays. Similarly they suggested a reduction in customs duty to benefit the agricultural labourer, and in connection with landholders the general introduction of death duties, the taxation of agricultural incomes and increased efficiency in income-tax administration. In 1922 a committee was appointed to inquire into taxation in the Dominion of New Zealand, and in Australia a Royal Commission on Taxation submitted its report in five volumes during the same period. Since 1914 the development of the theory of taxable capacity has made enormous strides, and the question of the ability of various nations to bear their respective tax burdens is a very pressing one.

THE INCREASE IN TAXATION

3. The growth of taxation has been due mainly to three factors : (1) Interest charges on war debts. The necessity for reducing this burden has led to further taxation. The War was financed mainly by borrowings, although in the United States, Great Britain, and Japan taxation was greatly increased to meet the usual peace budget and war interest charges from ordinary revenue. In view of Japan's limited participation in the War no great effort of a fiscal nature was necessary, but Great Britain and the United States courageously appealed to the country to pay heavier taxes for a national cause. It was not difficult for Great Britain to increase her tax revenue, for she was rich and had a flexible income-tax system ready at hand. The United States of America increased her tax revenue by the imposition of new taxes such as the federal income tax as well as by the enhancement of the old. (2) The extension of the functions of the State, especially in regard to education and other social services ; and (3) the increase in the general level of prices.

The increase in the tax revenue of the chief countries is seen in the detailed table No. XIII., App. This is given below in summary form. In this table statistics have been gone into very carefully, and include as far as possible central or federal, provincial or state, as well as local taxation. Tax revenue only has been included, and not the total State revenue. It will be seen

that taxation has increased more than wholesale prices and the cost of living in all the countries.

THE INCREASE OF TAXATION

Country.	Year.	Percentage increase in Taxation over 1913-14	Wholesale Prices (Official Index)	Cost of Living (Official Index).
			1913-14 = 100	
United Kingdom . . .	1934-35	234	105	141
India	1933-34	84	95	100
Canada	1931-32	214	113	143
Australia	1932-33	328	127	119
The Union of S. Africa .	1932-33	93	89	115
United States	1922-33	307	90	130
France	1933	860	81	87
Japan	1931-32	234	116	135

PER CAPITA TAXATION AS AN INDEX OF THE BURDEN OF TAXATION

4. The *per capita* taxation obtaining in various countries is one method of showing tax burdens, and is perhaps the commonest. It gives perhaps a better idea of the relative burdens than the volume of taxation itself,¹ as the latter ignores the population over which the taxation is spread. At the same time international comparisons require to be used with caution owing to differences in national wealth, financial systems, and social and economic structure of the countries compared. The standard of living varies so greatly in some cases, as between India and the United States, Japan and Great Britain, that *per capita* figures cannot be taken in themselves as affording a correct comparison of the burden or weight of taxation. Had it been possible to have the gross sales of goods at wholesale both in domestic and foreign trade it might have been possible to use the relation which taxation bears to those sales. This, however, in the present state of statistical knowledge is impossible as most countries have no such details of their domestic trade. We are therefore driven back to weigh the relative tax burdens of peoples by putting their total

¹ *Vide* Table XIV., App.

PER CAPITA TAXATION

Country.	Taxation per Head.				
	Pre-War Year 1913-14.		Year	Post-War Year.	
	All Taxation (Federal, State, Local).	Excluding Local Taxation		All Taxation (Federal, State, Local)	Excluding Local Taxation
United Kingdom .	£ 5 11	£ 3 11	1934-35	£ 18 17	£ 15 1
India .	0 5	0 5	1933-34	0 9	0 8
Canada .	5 9	4 1	1931-32	13 5	7 17
Australia . .	5 12	4 14	1932-33	14 1	11 9
South Africa .	1 18	1 14	1932-33	3 5	3 2
United States .	4 6	2 0	1932-33	21 7	9 1
France . .	4 14	3 7	1933	12 17	10 5
Japan .	1 1	0 14	1931-32	3 0	1 13
Germany ¹ . .	1 11	1 11	1930-31	5 0	5 0

* State and local not included.

earnings, and wages, income, etc., from other sources into one of the scales, and into the opposite scale the amount of taxation plus the difference between the national income and this weight. In other words the *per capita* income can be calculated. The preceding table summarises the detailed table, and gives the taxation per head in the pre-War year including and excluding local taxation, and also in the post-War year. In Germany and other countries State and local taxes have been included as well as federal and central. The United States (federal, state and local) leads with a *per capita* taxation of £21 : 7s. Great Britain comes next with £18 : 17s. per head. Australia and Canada are more or less near to Great Britain. In the case of South Africa it is necessary to remember that a substantial portion of the tax revenue is paid by Europeans, while the African native and the Asiatic contribute very little in the form of taxation either direct or indirect to the Treasury. If due consideration is made for this the *per capita* taxation in the Union of South Africa may be as much as other European countries. Of countries where statistics are available India was the lowest with 9 shillings per head in 1933-34. Japan is the last but one with a *per capita* taxation of £3. When local taxation is excluded the order of these countries is affected

to some extent especially in the United States and federal countries generally.

DISTRIBUTION OF DIRECT AND INDIRECT TAXATION

5. Another method of estimating the burden of taxation is to look to the distribution of taxation of direct and indirect taxes.¹ The real burden cannot be discussed without examining what the

DIRECT AND INDIRECT TAXATION

Countries	Proportion of			
	Direct Taxes.		Indirect Taxes.	
	Pre-War, 1913-1914	Post-War.	Pre-War, 1913-1914	Post-War.
United Kingdom . . .	47.8	56.4†	52.2	43.6†
India (Central and Provincial) . . .	46.9	36.4†	53.1	63.6†
Canada (Dominion and Provinces) . . .	8.6	40.8‡	91.4	59.8‡
Australia (Commonwealth and States) . . .	9.6	31.7‡	90.4	68.3‡
South Africa (Union and Provinces) . . .	32.0	56.8§	68.0	43.2§
Japan	28.4	24.5‡	71.6	75.5‡
France*.	39.5	27.6||	60.5	72.4||
Italy	31.7	27.0‡	68.3	73.0‡
United States (Federal) . .	11.0	48.4||	89.0	51.6||

* Pre-War year 1913. † 1933-34 ‡ 1931-32. § 1934-35. || 1932-33

taxes are and in what proportion they are a definite burden upon individuals. This may seem a self-evident proposition, but in inquiries of this sort it is not always so obvious. What are the direct taxes and what are the indirect taxes, and what is the proportion of direct taxes such as those on income, successions, or inheritance, etc., to indirect taxes? The preceding figures show the direct and indirect taxation before and after the War in the chief industrial countries. The figures have been compiled with care from the budgets of these countries. Taxation figures only and not total revenue figures have, of course, been included.

¹ See also Chapter XVII.

PERCENTAGE OF TAXATION TO NATIONAL INCOME
AS AN INDEX OF THE BURDEN OF TAXATION

6. It is now recognised that the best method is to consider the proportion of the total national income of each country taken in taxation. This gets over much, but certainly not all, of the difficulty arising from differences of wealth, population, social and economic conditions. This method of obtaining an approximate idea of the ability of various countries to bear their respective tax burdens is not scientifically exact, for it should be remembered that poor countries like some of the Balkan States or Turkey would find it much more difficult to pay taxes amounting to 15 or 20 per cent than a rich country would experience in paying 25, 30, or more per cent. Moreover, one has also to consider other indications, such as the ability of a country to make payments abroad as France did in the early part of 1924 without producing chaos in exchange and in price-levels. To arrive at national income the value of the commodities produced and the services performed which are exchanged for money are totalled for a twelve-month. Care must be taken to avoid duplication as far as practicable in adding up wages, salaries, rents, profits, remuneration for risk, and all other services, etc., which in general contribute to the income of an individual. In Chapter XV. the question of calculating national income has already been discussed. It will be recalled that the services of those who are not engaged in material production are included, since these contribute to the national "heap", and they have a claim upon produce or goods and services. Each one of us makes goods or performs services to sell, and it is this supply which represents the demand for the goods or services of others. The income which is obtained in a twelvemonth is the price received for the contribution to this heap or pond of goods and services in the same period, a heap or pond, as it were, which is ever changing. In calculating the national income we are not concerned with whether the income consists mostly of products from industry (as in Great Britain) or from agricultural produce (as in India and Hungary), or whether a considerable part of it is made up of the value of services. We evaluate all services in general exchange for money. It is true that duplication does in many cases arise, but with the progress of

statistics, especially in regard to the income tax in the present century, duplication is much less than hitherto. Interest on internal debt may form a part of the national income if we consider income from the standpoint of the Income Tax Commissioners. If, as defined above, income is the sum-total of goods and services, this interest cannot be said to be in the same sense part of the national income. It embodies no new services or commodities, but is a mere transference from one set of people to another. It is subject to taxation, and has been included for the present purpose of comparing the tax burdens of various countries. The two methods usually followed are: (1) to add, as we have seen, incomes of individuals, avoiding mere transferences as in the case of allowances to sons, doles to unemployed, and old-age pensions as paid in Great Britain; and (2) to find the value of the commodities produced and to supplement this wherever necessary. The former method is possible in advanced countries like Great Britain and the United States, while the latter is necessary in cases where income-tax statistics are not available in sufficient detail and comprehensiveness as in India. The income-tax statistics in the former case are supplemented by statistics of wages for incomes below the exemption limit. Stamp and Bowley in Great Britain and Helfferich in Germany have supplemented income-tax statistics in this way. Pupin in his book¹ divides the national income into income from capital and income from work, and estimates each separately. Under income from work he includes statistics of wages and salaries. In using statistics of wages very great care must be taken in order to avoid large errors in the result, and therefore comprehensive wage statistics are necessary. Some writers, such as King,² arrive at national income by valuing the production of the country as well as by multiplying the book income of families by the number of families in the class and adding up the whole. Other writers, such as Théry,³ estimate from death-duty statistics the national income by calculating what is the principal income from the different classes of property. The transfers of property by death or by gift are reported for tax purposes, and these are assumed to be one-fourth of the national income. Other writers build

¹ *La Richesse de la France.*

² *The Wealth and Income of the People of the United States*, 1922 (Macmillan, New York).

³ *La Fortune publique de la France*, Paris, 1911.

up their estimates by an analysis of the total wages bill, the revenue from property, industrial and agricultural profits and earnings. It is also possible to check these estimates by various statistics, as, for instance, the total national savings (*i.e.* net investments in shares, debentures, securities, etc.), long-term savings, import figures, and the currency in circulation. It is, for example, estimated that the national income before the War in France was one-fifth of the imports, and from this it is assumed that the figures represent the same proportion to-day as they did before the War. Similarly with circulation which is known it is assumed that circulation bears to the income the same proportion now as it did before the War. These, however, are very rough checks and are not to be relied on in view of other scientific and more accurate estimates that are available. In regard to Germany, if Central Budget figures only are given, it must be remembered that the Central Budget since 1918 carries sums formerly paid by the separate states of the Empire.

The results in Table No. XVI. are summarised in the table below, which shows the tax revenue (not total revenue) in proportion to the total national income including and excluding local

TAXATION AND NATIONAL INCOME

Country	Proportion of Taxation to National Income in				
	Pre-War Year 1913-14		Year.	Post-War Year.	
	All Taxation.	Excluding Local Taxation.		All Taxation.	Excluding Local Taxation.
Great Britain and N.					
Ireland . . .	11.4	7.3	1931-32	25.6	20.9
India . . .	4.4	4.0	1932-33	10.1	9.0
Canada . . .	13.0	9.7	1928	9.7	8.0
Australia . . .	10.4	8.9	1927-28	15.2	13.7
United States . .	6.4	2.9	1932	13.9	7.2
France . . .	13.8	10.2	1928	20.9	18.3
Germany . . .	10.5	..	1925	20.1	13.7
Japan . . .	17.2	12.6	1925	12.8	10.2
Italy . . .	..	8.6	1927	22.3	18.9

taxation. One lesson from the data is that Great Britain is not the only nation that is burdened with heavy taxation. In all

countries, except Canada and Japan, the proportion of taxation to national income has greatly increased during the post-War period as compared with the pre-War year, and in some cases, as for example, in Great Britain and Germany, it has been nearly double. The figure for India (10 per cent) will not surprise those who have studied in detail the productive capacity of the country at the present time. The burden of taxation, as has been shown, depends also on the standard of living or the productive capacity of a country's inhabitants, the method by which taxation is levied, the purpose for which taxation is used, and also the mentality of the people taxed. It should be remembered that over 70 per cent of the population in India and 60 per cent in Japan are engaged in agriculture. Agricultural countries cannot, and do not, produce the wealth of countries predominantly industrial. Progressive taxation is less burdensome to the lower income groups than proportionate taxation on all incomes whatever their size. Interest charges paid within the country are a mere transference of funds, and therefore do not constitute a heavy burden on the country as a whole. In an hour of patriotism more may be subscribed than in a generation of lethargy, and with less real effect on the population of the country.

When one country's taxation is compared with another or one portion of a country with that of another, there are some factors which may account for a higher burden of taxation. Among these may be mentioned area, density of population, cost of living, and the rate of wages. The cost of collection of land taxation may be high on account of the area covered by the staff collecting that revenue. Police expenditure and the administration of justice depend, among other things, on the density of population. One part of a country may be more expensive to live in than another. Expenditure will be higher, and so the taxation to meet that expenditure. Where there are, as in a centre of industry, other employments available, wages may be high, with the result that expenditure and taxation on the part of the State may also be high.

BROAD CONSIDERATIONS AND CONCLUSIONS

7. The broad general conclusion to which we have come is that the burden of taxation can be measured within a country not

merely at any one fixed point of time but also at different periods. This may be done in several ways. The usual method is to divide the total tax revenue by the population paying that revenue and to use this *per capita* figure as a guide to the burden of taxation. Another method is to take specimen incomes and to work out the direct, the indirect, and total taxation paid on those incomes on the lines described above in connection with the calculation of the direct and indirect burden of British taxation. From this it is possible to obtain a percentage of income paid as taxation. This method supplements the first method. Before making comparisons at different points of time in the same country we have to consider carefully the following points : (1) population and wealth ; (2) taxable capacity ; (3) the direction of public expenditures or, in other words, the way in which the proceeds of taxation were spent ; (4) the effect of direct and indirect taxes on trade ; (5) the existence or non-existence of internal and external debt, especially the latter, in the periods compared ; (6) the effect of taxation on saving in regard, for example, to the first of these points, population and wealth. The growth of wealth as compared with that of population must be studied in order to see the relative increase of wealth and population. In regard to the second of these—taxable capacity—we must see how the taxable capacity at one period compares with that of another. Was the taxable capacity in the former period less than in the latter ? How far was income tax better distributed ? Did it bear more heavily in one period than in another on small incomes ? Was indirect taxation in both periods levied on the same articles such as necessaries, and were there changes in the taxation of income in these two periods ? On the third point, the largely increased expenditure on the social services at the present time has to be remembered. Not so many decades ago expenditure on the social services was relatively little, and a century ago was hardly represented at all. The effect of the taxation on saving has also to be considered. Thus the Colwyn Committee in its inquiry analyses the effect of taxation on saving, and concluded that “ Taxation in 1818 hardly touched the saving power of the wealthy ; in 1923 it imposed a distinct limitation upon it ”.

Valuable conclusions may be obtained in the measurement of tax burdens within a country by the careful handling of statistics,

especially those referred to above. It is quite possible to obtain data which when read in the light of other data all point in the same direction. The result of such an inquiry amply repays the trouble spent in collecting the data. Some of the most valuable conclusions of committees on taxation are those connected with the burden of taxation. It is important that taxation should be spread over the population and not confined merely to a small section of it. A great majority contribute to taxation in an unobtrusive way through indirect taxation. It was for this reason that the Committee on National Debt and Taxation in considering the fact that indirect taxes were wrapt up in price said that it would be better if the great body of citizens were more conscious of the taxes which they paid as this would prevent wasteful expenditure especially at a time when some expensive policy was under consideration. It reached the general conclusion that the post-War taxes had not reduced the average or general standard of living of the working classes as compared with the pre-War. They made no doubt that customs and excise duties effected the purchasing power of people with small incomes, and that the burden of direct taxation was less crushing than is frequently represented. The burden of direct taxation, while we do not wish to belittle it, is less crushing than is frequently represented. It does not, with trivial exceptions, enter directly into prices, and its indirect effects are not such as substantially to affect the general price-level. It has a materially adverse effect on savings, but this does not hold good, so far as the receipts are applied to payments, on account of the internal debt. Again, it has widely diffused psychological effects, and has been responsible for a good deal of discouragement, while trade has been suffering from long-drawn-out depression due to wider causes ; on the other hand, some of the psychological effects have been actually beneficial. In our opinion the present taxation—even in conjunction with the loss of material wealth due to war expenditure, which lies behind the National Debt—is not one of the main causes of industrial difficulty. Causes other than taxation lie outside our province, but, in their very wide range, have been under the consideration of the Committee on Industry and Trade. For an analysis of the serious difficulties of our export trade due to one set of causes—conditions prevailing in various markets abroad—we may refer to the Committee's introduction to their Survey

of Overseas Markets (1925). The overseas conditions dealt with cover the decline of purchasing power, the shortage of capital, the growth of local manufacture, etc. So far as taxation is concerned, we think that, if general conditions improve and times become more prosperous, the burden will be carried with comparative ease.

These conclusions show, in short, the value of inquiries into the burden of taxation in a country at a definite point of time and also as compared with previous periods.

In regard to the international comparisons of the tax burden in one country with that in another the problem is far less easy, but is not insurmountable. Various committees of inquiry have, as we have seen, been disinclined to publish from time to time any definite indices, but have without doubt used such indices in order to come to conclusions such as the Colwyn Committee did when it stated definitely that "The burden of taxation was heavier in Great Britain than in any other European country and much heavier than in the United States". There are, necessarily, difficult problems among which are: (1) The amount of tax revenue levied in each country; (2) the calculation of the proportion of the tax revenue per head of population which the tax revenue bears to the national income. These issues seem simple ones, but they are complicated owing to the data of tax revenue and national income being different in different countries and, therefore, comparable only with difficulty; (3) the nature of governmental expenditure with special reference to its productivity in each country with which comparison is made; (4) the relation between national and local finance, and in federal constitutions between national, state, and local finance; (5) the social conditions and standards of living in the countries compared. One of the main reasons of the success of Japan in the world markets at the present time is its low costs of production in industry, which are very largely due to the plain and cheap living of the Japanese worker whose staple food is rice. An eater of beef cannot challenge him in respect of the low cost of living. Climate, too, has an effect on the standard of comfort which is sometimes overlooked. There are, in addition, other difficulties regarding (6) the comparative distribution of income and of wealth, (7) the incidence of the various taxes in the tax systems compared in

relation to the distribution of income and wealth in the countries compared ; (8) the general nature of the industries of each country with special reference to the relative demand for capital equipment ; and (9) how far public utilities run by manufactures or national concerns are run for profit (*i.e.* in addition to taxation) or at a loss (*i.e.* in remission of taxation). There is, too, (10) the element of psychology. It is quite possible that if we could measure the majority or even all of these factors set out above (factors 1 to 8), that notwithstanding a larger burden in one country this might be upset by the psychology of the people in the other country with which comparison is made. Let us assume that in Japan the burden of taxation was 10 per cent or even 20 per cent higher than in Russia, it is by no means certain that Japan would be placed at a disadvantage owing to the thrift, enterprise, and patriotism of her population, especially in times of stress. The attitude of Japan in the face of earthquakes, which are not infrequent, is an illustration of the attitude of mind which can bear burdens with unusual cheerfulness. The trained mind in reading comparative statistics of the burden of taxation finds these useful, as he has to weigh up several factors and to make mental reservations before coming to definite conclusions regarding the weight of taxation in the countries in regard to which comparison is made.

Lastly, the percentage weight of taxation that can be borne varies with circumstances. No definite percentage can be laid down as has been done, especially by some German writers of last century. It will depend on circumstances. The Hindu law-giver, Manu, said that an eighth, a sixth, or a twelfth of the grain may be taken by the Government (the King) but, adds the commentator Culluca, this is to be determined by the difference of the soil and the labour necessary to cultivate it ; a fiftieth of the annual addition to capital stock, cattle, gold and silver gems may also be taken. Manu wisely sees there can be no hard and fixed amount. "A military king, who takes even one-fourth part of the crops of his realm at a time of urgent necessity, as of war or invasion, and protects his people to the utmost of his power commits no sin." The tax on merchants which in times of prosperity was to be a twelfth of their crops and one-fiftieth of personal profits may be in times of distress raised to an eighth or a sixth or even one-fourth in great public adversity. The principle underlying Manu's

common sense will be appreciated since it was written so many centuries before the technique of tax burdens was ever considered. Tax burdens, it is universally realised, depend on many factors, and in a far greater degree than was ever dreamt of in the philosophy of this Hindu law-giver.

CHAPTER XXX

NON-TAX REVENUE

1. In Chapter XIII. revenue was classified under two major heads, tax revenue and non-tax revenue. This chapter deals with non-tax revenue and comprises what is usually known in financial literature as the public domain—lands and forests, and the industrial domain, which includes public undertakings such as irrigation works, railways, posts and telegraphs, and in countries where state or national banks are in existence state banking. The national and state banks in the United States and the central Bank of Russia, which is a State bank with State capital, are examples. The industrial domain includes also those public undertakings belonging to municipalities and other local authorities, the revenue from which is one of the most marked features in modern public finance. It is safe to prophesy that in the countries of chief industrial importance in the next few decades the revenue from these public utility companies will be a very important source of public revenues. The public domain in some countries, as we have seen in Chapter XIII., has almost vanished. The King no longer is the possessor of large areas of lands and forests as was the case many centuries ago in Great Britain. Public revenue to-day is chiefly from posts and telegraphs and other national utility services, as for example, railways in Germany and India and irrigation works in India and Egypt. There is a striking difference in the comparatively small percentage of non-tax revenue in those countries where there are no large utilities such as the railways and irrigation works of India. The non-tax revenue of Great Britain was 12·4 per cent in 1933–34 as compared with 37·6 per cent in the case of British India. The following table shows the percentage of non-tax revenue to total ordinary revenue in certain leading countries :

NON-TAX REVENUE

Country.*	Year.	Percentage of Non-tax Revenue to Total Ordinary Revenue.
Great Britain . . .	1933-34	2·4
Canada† . . .	1933-34	24·2
Australia† . .	1933-34	4·6
South Africa† . .	1933-34	30·7
India† . . .	1933-34	37·6
United States† . .	1932-33	36·1
France . . .	1934	27·2
Italy . . .	1933-34	5·1
Japan . . .	1933-34	35·3

* The percentages do not include Government monopolies, such as those in France, Italy, India, and Japan.

† Federal or central and state or provincial.

In the revenue accounts or Exchequer receipts of Great Britain the non-tax revenue includes receipts from the postal, telegraph, and telephone services, from crown lands, from interest on Suez Canal shares, etc., and administrative receipts by civil departments. The receipts are either ordinary or special. The special receipts were mainly from the sale of War assets and from reparations. Thus in 1922-23 the Disposals and Liquidation Commission paid to the Exchequer nearly £17 millions for the sale of surplus Government property and £10 millions for the sale of raw material. The Treasury also realised £14½ millions, which included £6 millions for repayments connected with advances in respect of pre-moratorium bills, £1,388,400 of gold salved from the *Laurentic*, £4½ millions for receipts under the German Reparation (Recovery) Act, 1921, and £2,300,000 received in cash from the Reparation Commission. In India about two-thirds of the central and provincial receipts combined are tax revenue, and the remainder is income from Government undertakings, such as railways, irrigation, other public works, posts and telegraphs, forests, the mints at Calcutta and Bombay, receipts in connection with civil departments, and interest on loans. The revenue from these heads is given in the table on p. 710.

In the United States ordinary federal receipts in 1935 were budgeted at \$3975 millions, of which \$176 millions or 4·4 per cent were non-tax. Postal revenues are excluded from these ordinary receipts. The French Budget amounted in 1932 to

	Non-tax Revenue. Percentage to Total Revenue.					
	1871-72.	1901-2.	Pre-War Year, 1913-14.	1921-22.	1932-33	
Government or public undertakings . . .	5·0	27·5	34·3	22·9	30·5	30·2
Receipts from social services . . .	..	0·3	0·4	0·4	0·8	0·9
Others (including interest on loans) . . .	5·6	4·6	4·9	10·0	4·8	6·5
Total . . .	10·6	32·4	39·6	33·3	36·1	37·6

Fr. 41,101 millions, of which State domains yielded Fr. 351 millions, posts Fr. 2806 millions, and miscellaneous non-tax Fr. 1638 millions. The Italian Budget estimates for 1932-33 show, out of a revenue of over 193,246 million lire, only about 14 per cent as non-tax revenue. The Swedish Budget includes as non-tax revenue receipts from posts and telegraphs, waterfall works, railways, domains, interest on shares in certain companies, e.g. the Swedish Tobacco Monopoly Co., Ltd., the Central Liquor Co., Ltd., and also a share in the profits of the Bank of Sweden. Similarly Holland includes the revenue derived from domains, State railways, the sum paid by the East Indies as interest and sinking fund for public debt, and the share in the profits of the Bank of the Netherlands, as well as certain other miscellaneous receipts. Japan in 1932, out of an ordinary revenue of 1477 million yen, budgeted for 719 million yen from taxation, and of the remainder (non-tax revenue) over 460 million yen was from public undertakings and State property.

2. It will be seen that in modern governments State enterprise and domains are not a negligible source of revenue. The importance differs from country to country and according to local conditions. The State as a capitalist and entrepreneur is, usually, at no small disadvantage, but it is the fashion from the time of Adam Smith to exaggerate its incapacity to conduct industrial enterprise. "No two characters", wrote Adam Smith¹ in 1776, "seem more inconsistent than those of trader and sovereign. If the trading spirit of the English East India Company renders

¹ *The Wealth of Nations*, Bk. V. ch. ii. part i.

them very bad sovereigns, the spirit of sovereignty seems to have rendered them equally bad traders. While they were traders only, they managed their trade successfully, and were able to pay from their profits a moderate dividend to the proprietors of their stock. Since they became sovereigns, with a revenue which, it is said, was originally more than three millions sterling, they have been obliged to beg the extraordinary assistance of Government in order to avoid immediate bankruptcy. In their former situation their servants in India considered themselves as the clerks of merchants; in their present situation those servants consider themselves as the ministers of sovereigns." While he realised the advantages of State banks as a source of revenue, he wrote, "The orderly, vigilant, and parsimonious administration of such aristocracies as those of Venice and Amsterdam, is extremely proper, it appears from experience, for the management of a mercantile project of this kind. But whether such a Government as that of England, which, whatever may be its virtues, has never been famous for good economy; which, in time of peace, has generally conducted itself with the slothful and negligent profusion that is perhaps natural to monarchies; and in time of war has constantly acted with all the thoughtless extravagance that democracies are apt to fall into, could be safely trusted with the management of such a project, must at least be a good deal more doubtful," and he adds, with reference to the post office, that "it is perhaps the only mercantile project which has been successfully managed by, I believe, every sort of Government. The capital to be advanced is not very considerable. There is no mystery in the business. The returns are not only certain, but immediate."¹

Some of the reasons why the author of *The Wealth of Nations* supports Government's management of the post office would equally well apply to other activities which modern States now undertake. The example of India in the sphere of irrigation, railways, and forests, of Egypt in irrigation, of Japan, France, Italy, and Germany in regard to monopolies, not to mention the remarkably successful administration before the War of railways in Prussia, may be instanced. An efficient corps of officials, like that of Prussia, is certainly not unknown in other countries of the world. The spread of education of a high type and the growth

¹ *Op. cit.*, *idem*. Cannan edit. vol. ii, p. 303.

of the influence of universities with old traditions are having an incalculable effect on the younger men of all the chief industrial countries. Men of sterling character, able to produce as civil servants work of meticulous accuracy and finish, are the products of our schools and universities. The experience, therefore, of State enterprise in the twentieth century is on the whole against the disparaging criticisms of Adam Smith.¹ It is, as we shall see, frequently necessary, on political and on economic grounds, for public authorities to undertake functions of an industrial and commercial nature. It is not always the case that production suffers from public ownership. Indeed it was urged before the British Coal Commission of 1919 that nationalisation of the coal mines would lead to increased production.

THE PUBLIC DOMAIN—LAND AND FORESTS

3. In the early history of modern States the royal domain was the basis of the public revenue. With the growth of time and the progress of society land as a source of revenue declines. When, for example, William the Conqueror arrived from Normandy he found that the Anglo-Saxon kings “had enjoyed great landed possessions, and flocks and herds. They had possessed rude castles, jewels, and richly embroidered robes of state. They had had a royal hoard kept in the king’s castle, where there were leather bags filled with the roughly minted silver coins of the time.”² The Norman kings claimed the royal demesne with the forests, the land held by the rural tenants and the holdings of urban tenants in cities and boroughs founded on folklands, from which the sheriffs collected rents. With successful wars the royal lands grew. They grew too through resumption by the king. They decreased mainly through expensive wars, which had to be financed, and through their bestowal on favourites. Thorold Rogers mentions how in the fifteenth century, in England, land belonging to the Crown was squandered away. In France the king similarly lost his estates, but here a large amount fell into the possession of the communes.

¹ Cf. Leroy-Beaulieu, *Traité de la science des finances*, ch. ii. (De l’importance des revenus de l’état moderne considéré comme propriétaire ou capitaliste et comme industriel); also chapters iii.-vi. Paris (Guillaumin), 1879.

² Fisk, *English Public Finance*, New York (Bankers’ Trust Company Publications), 1920.

Space will not permit an account of the continual alienation and resumption of the State lands in Western Europe as, for example, during the period of the Tudors and the Stuarts. During the reign of William and Mary the royal domain greatly decreased. "At the end of William's reign", as Sir Erskine May puts it, "Parliament having obtained accounts of the state of the land revenues, found that they had been reduced by grants, alienations, incumbrances, reversions, and pensions, until they scarcely exceeded the rent-roll of a squire." It was from this time impossible to look to anything but taxation for the carrying on of the State. To-day State lands are, as in France, Italy, and Spain, of little importance from the revenue point of view. In the most recent budgets available the percentage of ordinary revenue from State domains is 1·3 per cent in Great Britain, 0·9 per cent in France, 0·1 per cent in Italy, and 0·9 per cent in Spain. In Russia before the Revolution of 1917 there were very large State domains and forests. There were also large estates held by private individuals. By the Constitution of 19th July 1918¹ private property in land is no longer permitted. Land, forests, mines, factories, and railways are national property. The "new economic policy" (March 1921) has modified the law and permitted the leasing of nationalised industries, and the concentration of State control on the most important of the nationalised enterprises. No up-to-date financial statistics are available to show the effect of this policy on non-tax revenue, especially on landed estates including forests.

In India the State possesses in theory, except in the permanently settled tracts, a right to the land. It has never given up this right, a right inherited long before the days of pre-British rule. We have, however, dealt with this in Chapter XX. on land taxation. The system of assessment and of collection has already been described. Under the new Constitution land revenue is a provincial (and not a Central) head of revenue. In the financial year ended 1929, land revenue was Rs.33 crores (£25 millions) or 34 per cent of the total provincial revenue of the various Governments. Forest revenue, also a provincial head of revenue, was Rs.6 crores (£4 millions) or 6 per cent of the total provincial revenues. Of this about one-third

¹ Amended 1919-22.

was from one province only, viz. Burma. The total forest area in India covers more than a quarter of a million square miles, and only about 99,000 square miles of this has been brought under regular scientific management. It is often forgotten how much wealth proper afforestation brings to a country. Next to the discovery of root crops by which live stock was kept over the winter, and not killed off, nothing has brought such an accession of wealth to Scotland as the afforestation, especially of the eighteenth century. Deforestation in India had probably been going on for hundreds of years, until, in the nineteenth century, a Forest Department was set up. By the destruction of trees water is no longer stored and doled out gradually, with the result that the vegetation and surface soil are swept away. On the other hand, the absence of wood for fuel has resulted in animal dung being burnt as fuel instead of being used as manure to fertilise the land.

In new countries where capital and labour are scarce, land is sold by the State as an incentive to immigration. These lands if sold should, as Wakefield pointed out in the thirties of last century, not be granted promiscuously but sold at an adequate price and in a regular fashion, and the proceeds should go to assist further immigration.¹ The interests of the settlers in the United States, Australia, New Zealand, as well as in Canada, were those which shaped land policy in these countries during the nineteenth century. In the United States as early as 1775, one year before the publication of *The Wealth of Nations*, it was decided by wise statesmen to set aside part of this great source of wealth for the development of education. In each township Section No. 16 (*i.e.* 640 acres or one-thirtieth of the area) was reserved for the support of schools. From 1848 Section No. 36 was also granted for public (or high) school purposes. Thus one-eighteenth of the area of each township in every state of the Union was reserved for education. In 1787 it was provided that not less than two townships of land were to be granted in each state for the support of a State University by the Federal Government, and in 1866 for agricultural and industrial education an amount equal to 30,000 acres for each senator and representative was granted to each

¹ House of Commons Paper 512, 1836; cf. Mill, *Principles*, V. xi. § 14: cf. Wakefield's *England and America* (1833).

state, and it is on this that agricultural colleges largely depend for their funds. No Federal Government could have tried to do its duty more fully than that of the United States in this respect, but this is not to be wondered at in view of the great names like those of Thomas Jefferson, John Adams, and George Washington, associated with the early history of this great Republic. The sales of land in the Federal Budget of the United States are credited as income, and in 1926 and 1927 were only \$1,375,000 out of \$8091 millions of ordinary receipts.

THE PUBLIC DOMAIN IN COMMERCE AND INDUSTRY

4. Another class of non-tax revenue is that which is derived from the commercial and industrial activities of the State. Some writers term this branch the industrial domain, but this hardly covers activities outside industries, such as transportation. Leroy-Beaulieu¹ more appositely, though not quite correctly, calls this "the industrial and financial domain of the State", since it covers, for example, the profits accruing to a State which possesses a State bank. The public domain in commerce and industry includes mines ; factories (*e.g.* arsenals) which are not primarily for revenue purposes ; public works, such as irrigation, drainage, water and lighting, and posts, telegraphs and telephones, roads, canals, and railways.

5. From early times mines have been public property, as, for example, the silver mines of Laurium in Athenian history, and gold, silver, and salt mines in the history of Rome, gold and silver being worked directly by the State slaves. Until 1688 in England all mines yielding gold or silver were the property of the Crown. In the fourteenth and fifteenth centuries charters were granted to prospectors to enter upon private lands to search for ores. The rights of the lords or seigneurs were respected to the extent that the mining charters prohibited without a licence from the overlords mining under houses, sometimes under arable lands and meadows. A double royalty was thus imposed. In the time of Edward IV. a lease of copper mines reserved a royalty of one-eighth to the king and one-sixteenth to the landlords. In

¹ *De la science des finances*, ch. vi. p. 93, "L'État a quelquefois un domaine industriel et même un domaine financier, par exemple des participations dans des banques ou même un portefeuille de valeurs mobilières. La Prusse est le plus frappant exemple de cette organisation."

1688¹ a great change took place in the law. An act was passed that no mine of copper, tin, iron, or lead shall hereafter be adjudged, reputed, or taken to be a royal mine although gold or silver may be extracted out of same. By an act of 1693² the act of 1688 was modified, the Crown being given the right of pre-emption of the metal at such price as would represent its fair value in the absence of royal metals. In the case of a mine worked for gold the prerogative of the Crown was, it is interesting to note, confirmed by the Court of Appeal in England as late as 1891. Roscher points out that in Germany there was a system of free mining, where the land could be opened up notwithstanding a protest from the landowner if royalties were paid to the State. In some countries much of the mineral wealth was held to be public property. Prussia is a case in point.

The position to-day in most countries is for mines to be handed over to private enterprise for development as far as possible, including those which possess a natural monopoly. There is a great deal in what Adams says regarding financial policy and mines. "Mines", he points out, "that are widely spread and easily discovered may be treated like the property of ordinary industries. No special financial policy is required for minerals like coal, iron, or salt. Mines, on the other hand, which form the basis of a natural monopoly should be handed over to private enterprise for development, but they should, at the same time, be recognised as a fit object for special and peculiar taxation."³

6. States have sometimes to undertake the manufacture of goods when this cannot be satisfactorily done within the country itself. In India, for example, there are arsenals which manufacture munitions. Army clothing, however, is manufactured by private firms, such as those in Bombay and Cawnpore, and purchased by the Army Department. In some countries the State itself manufactures the goods, as it believes, usually wrongly, that private contractors are unable to undertake the work without undue costs in regard to supervision. Where industry is unable to meet the wants of the State it is necessary to keep these State concerns going. They have the advantage of sometimes preventing prices from rising, but public authorities

¹ 1 Will. and M. c. 30.

² 5 Will. and M. c. 6.

³ *Science of Finance*, p. 239 (New York: Henry Holt and Company).

should not undertake such industries, except in the earlier stages of development, and then mainly for experimental purposes, and also where the establishment of a monopoly is ostensibly advantageous. An important point in such concerns is the keeping of strictly commercial accounts. Interest should be paid on capital. Provision should also be made for depreciation of machinery and plant, for a pension fund, rents for land, and income tax in order to arrive at the true net profit. State concerns sometimes show a surplus, but the point is how much of this is really profit? The fact that State enterprise is carried on at a loss does not necessarily prove that it should not be undertaken. It may be desirable that certain services should be performed by Government even at less than cost price, as, for example, the manufacture of vaccine or serum.

The cost of Government monopolies has been discussed in a previous chapter, since they are best treated as a part of revenue raised by taxation. Municipal trading nowadays undertakes the supply of water, drainage, and frequently lighting. Thus in the city of Bombay, with a population of 1,200,000, the Municipal Corporation undertakes the heavy task of water supply and drainage, while a company undertakes the supply of electricity and electric tramways. In most countries, while the municipalities supply water and provide for the disposal of sewage, the question of lighting is not uniform. In brief, the position of public authorities—federal, State, or provincial or local—deserves in the domain of commerce and industry the most constant watching. Only occasionally are real profits made, *i.e.* sums paid in relief of the rates in local finance or taxation in State or federal finance.

7. A not unimportant item of revenue in some countries is irrigation. The returns on irrigation in India, for example, have been very satisfactory. At the present time the total length of canals and distributaries in operation in British India amounts to 75,000 miles, irrigating an area of 29.75 million acres or 12.5 per cent of the entire cropped area. The total value of the crops raised on the irrigated area during the years 1921–22 to 1925–26 was on the average one and a half times the total capital expenditure on works. The total capital outlay on irrigation works in 1932–33 was £109,500,000 and the net revenue was £9,325,000, so that the net return on capital was 5.35 per cent. Many of these

irrigation works yield a much higher return, of course, than 7 or 8 per cent. This is the average of all the works. In Sind the Sukkur Barrage Project, designed as the biggest irrigation works in the world, irrigates an additional five million acres. Two-fifths of the irrigation revenue is derived from the Punjab, where there is also a large scheme called the Sutlej Valley Project in progress. This when completed will irrigate the area of more than five million acres. The importance of the scheme can be seen from the fact that 3·75 million acres of desert now waste will be brought under cultivation. When works now in progress are completed it is estimated that a total area of 50 million acres will be irrigated by Government works.

8. Of those concerns yielding a revenue to the State, post offices, telegraphs, telephones, canals, tramways, and railways are examples. Almost without exception the post office has been regarded since Adam Smith's time as suitable for public management. In its early history it was in the hands of private individuals or privileged bodies, such as the messengers of the University of Paris. In view of the influence of the post office on other countries it will be necessary to examine its history in some detail. About the middle of the sixteenth century foreign merchants instituted a service to the Continent, which subsequently, owing to disputes among them, was placed under Government control. In 1635 it was possible to send private letters by the posts within Great Britain, and a monopoly on existing postal routes was proclaimed and made effective by cheap rates. For a single-sheet letter the charge was 2d. for 80 miles or less and 4d. up to 140 miles. Over 140 miles 6d. was charged, and 8d. to Scotland. From 1644 to 1650 Edmund Prideaux was postmaster and worked at his own cost, the postage for letters being his receipts. In 1650 he paid Government a rent of £5000 a year. In 1653 he ceased to be a postmaster, and the office was farmed for £10,000 a year. The profits from postage alone were estimated at from £14,000 to £20,000. In 1657 the first Act of Parliament regulating the post office was passed, reducing the rate beyond 80 miles to 3d. for England and 4d. for Scotland. From 1660 the post office was farmed for £21,500, and in 1663 the revenues of the post office were assigned to the Duke of York. In 1677 the Duke of York himself took the management into his own hands, and in 1685, on his accession, it became a part of the personal revenues of the

Sovereign, valued at £65,000. From 1720 Ralph Allen of Bath, the precursor of Rowland Hill, developed a system of cross-country posts between the six main post-roads. A daily post on many of the main lines was also introduced by him. In 1761 his account showed a profit of £12,000. In 1837 the privilege enjoyed by Members of both Houses of Parliament of franking, which led to so much abuse, was discontinued through the efforts of Rowland Hill. As one noble lord wrote : "The loss of consequence from ceasing to be able to frank a letter for a lady or, in travelling, for the waiter at an inn, gave great disgust to many members of both Houses, and made some of them openly declare that there was no longer any use in being in Parliament".¹ It is estimated that as many as 5 million letters a year were franked by Members of both Houses of Parliament, not to mention miscellaneous packages of various sizes. In 1840 Rowland Hill's plan of a penny postage was introduced after much difficulty, together with pre-payment by means of stamps. The postmen had no longer to collect on each letter the postage on delivery, an expensive business, since it is the collection and distribution of letters that run up the cost. With this reduction of cost there was an improvement in delivery. France adopted in 1848 a lower postage, which was doubtless brought about by the reforms begun by Rowland Hill, and, as in England, this produced at first a decline in gross revenue.

In recent years the work of the post office has increased, but in most countries one is struck by the revenue produced. To-day almost all countries follow the principle of charging according to what the traffic will bear. The charge is not according to the distance or the nature of the letter, but according to the weight of the letter. In addition to the fact that rates are irrespective of distance, there are also other peculiarities regarding postal charges, viz. (1) the rates are low and (2) vary according to the classification of packages. This latter point may be said to protect the post office from being deluged with articles too large to handle with ease. The post office also remits sums of money in small amounts by telegraph as well as by post. The remittance by post is in some countries of considerable importance ; the remittances by money order in the case of India in 1927-28 being 39 millions in number valued at Rs.95 crores. There are also

¹ Sydney Buxton, *Finance and Politics*, vol. i. p. 1404.

other functions of post offices, *e.g.* (1) the granting of postal life insurance policies, (2) savings banks, (3) the sale of cash certificates, (4) the collection of articles sent by post, (5) the sale of quinine, and (6) in some countries the payment of small pensions which is effected through post offices. In certain countries the postal receipts are not included in the ordinary budget but form a separate autonomous fund. In Germany, for example, since March 1924 the postal and telegraph services form an autonomous undertaking holding its own assets and liabilities. Of the current revenues 0·8 per cent is paid into a reserve fund till it rises to 100 million marks, when the whole surplus will accrue to the Treasury. The postal, telegraph, and telephone services in Italy form an autonomous undertaking from 1925–26. Similarly in New Zealand receipts from posts and telegraph are paid into a separate account since April 1928. Telegraphs, telephones, and wireless are the usual functions now closely allied with postal services. The telegraph was used in England as early as 1837, and in 1847 to transmit the Queen's speech to the provinces. By 1868 telegraphs had extended all over England.

The question is frequently raised whether the post office should be expected to produce a considerable revenue to the State or whether it should simply pay its way. In most countries the monopoly does not yield much revenue to the State, as will be seen below.

American writers, notably Adams, hold that "the aggregate of receipts must cover the aggregate of cost; but in the attainment of this result greater regard should be had to volume of service rendered than to the charge upon the unit of service".¹ While much is to be said for the American point of view, there is the necessity of seeing that there is certainly no loss, and in this particular we refer to the necessity of regarding the post office, including telegraphs and telephones, as a running concern. There is undoubtedly a considerable amount of capital sunk in the undertaking for which a business concern would charge interest and depreciation before showing profit. Any charge beyond a small claim would be in the nature of taxation. For telegraphs a very high purchase price for the concern has been paid in many countries; and this, together with the desire on the part of the public to have low telegraph rates, has militated against suc-

¹ *Science of Finance*, p. 279.

cessful financial results. As in the case of municipal enterprise commercial accounting must be followed, and debt charges, both for sinking fund as well as interest, should be deducted from the gross receipts in order to arrive at the net income or profit. The following table shows the net revenue of the postal, telegraph, and telephone services in certain chief countries :

NET REVENUE OF POSTAL, TELEGRAPH, AND TELEPHONE SERVICES

Country.	Year.	Post Office.	Tele-graphs	Tele-phones.	Total.
United Kingdom (million £)	1928-29	9.2	- 0.8	0.6	9.0
India (Rs. lakhs) . .	1928-29	..	..	..	7*
Canada (million \$) . .	1926-27	..	..	..	- 2
Australia (million £) . .	1927-28	..	..	..	- 0.1
South Africa (million £) . .	1925-26	..	..	..	0.7
France (million francs) . .	1929	..	..	..	44.5
Switzerland . .	1928	7.3	2.7	..	10.0

Note - indicates deficit.

* Posts and telegraphs alone.

In Great Britain, for example, the old age and similar pensions are paid through the post office. The pensioner is provided with a bound book of orders, showing the date of payment and the amount of the pension. The order is presented to the post office by the pensioner or his agent in case of sickness and the paid orders are kept by the post office as vouchers. Nearly 2,000,000 pensioners are included in the scheme. Besides this, war pensions which amount to more than £50 millions are paid through the post office. The postal cheque system, which is the recognised feature of French finance, has been more prominent during recent years. There are at present about 370,000 depositors, and about 161,000,000,000 francs are annually paid into postal cheque accounts.

RAILWAYS

9. The next group after posts, telegraphs, and telephones is roads, canals, tramways, and railways. The maintenance of roads is usually undertaken by local authorities, except in the case of the main arteries, which sometimes are paid for wholly or partially by the State or central authorities. Tolls, however, are now regarded as antiquated and cannot be considered to be

a revenue-producing agency. The cost of upkeep with the great development of motoring is nowadays very great, and forms a large item of expenditure of local authorities in Great Britain. Canals, largely owing to the growth of railways, do not now, with rare exceptions, yield much, if any, revenue. There are, it is true, certain canals of importance, even at the present time. The Suez Canal, 100 miles in length and built in 1869 at a cost of nearly £30 millions, produces revenue to the British Government and other shareholders. The income during 1928-29 was £28.1 millions to the British Exchequer. The Manchester Shipping Canal (which cost approximately half the Suez Canal) was open to traffic in 1894, and for the year ending December 1922 the revenue was £792,800 on a paid-up capital of £17,423,000 or 4.6 per cent. The total length of canals in England and Wales is 3641 miles and 184 miles in Scotland. On the whole they do not pay their way, and this is not peculiar to Great Britain but is found in Germany and in the state of New York. In France canal dues were abolished 44 years ago.

Tramways are usually, but not always, worked by local authorities. At the end of December 1928 there were in Great Britain 2514 route miles open for traffic. The net receipts were £7,478,000, the total paid-up capital being £104 millions, showing a return of 7.2 per cent on the capital. In some centres of large population, as in London, tramways in recent years have not been able to compete with private bus companies. Tramways have usually to bear part of the upkeep of roads. In the last accounts of the London County Council there is a charge, for example, of £269,500 per annum in the tramways accounts for maintenance of the road service which the Borough Councils would have had to meet if there were no tramway system. Tramways are, in these circumstances, sometimes unable to pay a suitably high rate of wages.

Next, with regard to railways. The importance of this domain may be seen from the fact that the mileage of the world's railways is to-day over 760,000 miles, of which approximately one half is in America and one-third in Europe. America and Europe account for a total of four-fifths of total world mileage or 80 per cent. Of the remaining 20 per cent 11 per cent is in Asia, 5 per cent in Africa, and 4 per cent in Australia. A great authority estimated at the end of last century that railways probably repre-

sented one-tenth of the total wealth of the civilised nations, and one-fourth, if not one-third, of their total invested capital, an amount much higher than any other important undertaking.¹ To-day the railway density, *i.e.* the number of miles of railway per 100 square miles, is greatest in Belgium and lowest in Persia. Great Britain, Holland, and France are far behind in this respect. In railway mileage per 10,000 inhabitants Australia (Western Australia) holds the premier position, followed by Canada, New Zealand, the Argentine, and the United States. In this China holds the record for isolation. The railway mileage is evenly distributed between the new world and the old world. The

Country.	Year.	Capital. (000,000)	Working Expenses. (000,000)	Net * Earnings. (000,000)	Percentage to Capital of	
					Working Expenses.	Net Earnings
United Kingdom	1920	£1328	£262	£53	19·7	4·0
India . . .	1922-23	Rs.6690	Rs.730	Rs.330	10·9	4·9
Canada . . .	1920	\$2341	\$515	\$24	22·0	1·0
Australia . . .	1921-22	£251	£30	£8	12·0	3·2
New Zealand .	1922-23	£40	£5·5	£1·2	13·8	3·0
Union of South Africa . . .	1922	£105	£21	£2·5	20·0	2·4
U.S.A. . . .	1922	\$22,300	\$4500	\$1100	20·2	4·9
Japan . . .	1920	Y.1188	Y.271	Y.78	22·8	6·6

* After deducting from the gross earnings working expenses only.

United States possesses a greater mileage than the whole of Europe, the figures being respectively 264,000 and 238,000 miles. The average miles of line per 10,000 population is 5·8 for Europe, 22·0 for North America, 0·8 for Asia, 22·4 for Australia, 8·4 for South America, and 3·5 for Africa. The capital invested is over £9000 millions, divided evenly between Europe and the rest of the world. The United States on account of its great mileage (264,000) has the largest amount of capital, over £4000 millions. The capital cost on a route mileage basis is greater in Great Britain than in other countries because of the high standards of the original builders and of the Board of Trade's safety requirements. This, together with the fact that many of the lines are double or treble, accounts for the comparatively high cost. The route mileage capital is also high in Holland, Belgium, France,

¹ Hadley, *The Railways of America*, London, 1890.

and Italy. The financial result of railways in various countries are set out in the table on previous page.

There are only a few countries in which railways are privately owned, the most important being the United States (250,000 miles), Great Britain (24,000 miles), and Spain (10,000 miles). In most countries railways are owned by the State, and worked either by the State or by the State and private companies.

The question of State or private ownership does not make any considerable difference in the system of rate making adopted by an efficient railway. A State railway arranges its rates to pay

THE STATE DOMAIN—RAILWAYS

I. *State operated*

	Miles.		Miles.
Russia	46,000	Rumania	7,000
India	38,000	Belgium	5,000
Germany	36,000	Switzerland	4,000
Australia	27,000	Austria	4,000
Mexico	16,000	Denmark	3,000
Italy	13,000	New Zealand	3,000
Poland	12,000	Norway	2,000
Union of South Africa	12,000		

Total (15 countries) = 228,000 miles.

II. *State and privately operated*

	Miles.		Miles.
Canada	40,000	Japan	8,000
France	26,000	China	7,000
Argentina	22,000	Chile	5,000
Brazil	17,000	Hungary	4,000
Sweden	9,000	Holland	2,000

Total (10 countries) = 140,000 miles.

interest on its capital just as a private company has to do. In theory the operating of railways by the State has much to commend itself, but the question is one which can be argued only after an examination of local conditions. Where the officials are as intelligent and as energetic as those in private companies, and able to act in the interest of the public to the same degree, the monopoly which the Government enjoys will not be abused. In fact it may be otherwise. "The question", says Hadley, "is one which practical railwaymen have long since ceased to argue on general principles; they recognise that the answer depends upon the respective degree of talent and integrity which characterises

the business community on the one hand and the Government officials on the other."

The Acworth Committee on Indian Railways, while favouring State operation for India, set out the case thus : " An important and weighty section of opinion, including that of the Railway Board, is opposed to the view that State management is the best, holding that, as railways are primarily commercial undertakings, they should be managed on a commercial basis, so as to secure economy and efficiency, that is to say, by a company with a Board of Directors. The following are held by the same body of opinion to be some of the defects in State management : (1) Constant transfers of senior officials, resulting in lack of continuity of policy ; (2) the tendency to give promotion on the grounds of seniority alone without sufficient regard to efficiency or local knowledge ; (3) disregard of public opinion ; and (4) lack of initiative and flexibility. Further, as regards the co-existence of company-managed railways and State railways, it is urged that improvements in the administration of State railways, which have been effected during past years, are mainly due to the emulation inspired by company management ; in other words, that the initiative lies with the company-managed railways, and that emulation and comparison provide healthy results in the case of State-worked lines."¹ The case for State management was expressed as follows : " A large section of the Indian public supports the adoption of this system, because it believes that company management does not encourage the development of indigenous industries by sufficiently favourable treatment ; that it gives preferential treatment to import and export goods ; that under the present system of company management large profits are made in British interests ; and that hitherto the companies have not employed Indians in higher appointments except to a very limited extent, and have not granted them adequate facilities for technical training. Without pausing to argue here whether these views are correct or not, we venture to think they are coloured by the impression that company management necessarily connotes management through Boards in London. This, however, is not an essential condition of company management in India."² In India it may be noted that the State generally owns the lines, and the lines are worked either by State

¹ Cmd. 1512 of 1921, paragraph 254.

² *Ibid.*, paragraph 255.

or (a) guaranteed and (b) independent companies. The State lines comprise more than two-thirds of the combined total lines of British India and Native States. At the present time India occupies the third place in respect of railway mileage among the countries of the world and nearly 90 per cent is State property and under Government financial control, while one-half is already under State management. The Government was committed to a policy of transfer of management to India as the companies' contracts fell in. The old controversy of State versus company management is now dead, and the State management has so far been financially and otherwise a success. On the other hand, Great Britain and the United States afford the best example of railways managed by private companies.

The Prussian railways were for long regarded as probably the best-operated State railways in the world.¹ The railways in other states of the German Reich did not yield a large return on the capital sunk in them. From 1st April 1920 the various State railways, including those of Prussia, were transferred to the Federal Government. In accordance with the Dawes Plan German railways were transferred to a private German company (the Reichsbahn Gesellschaft) with a nominal capital of £1,300,000,000, which manages the system. The railways are the property of the State. It is the largest railway company in the world, the mileage being 58,388 kilometres or 36,281 miles. The Government is a large shareholder, holding £650 millions of fully paid ordinary shares. In France by the law of July 1842 the construction of railways was left mainly to companies, but are subject to control by Government authorities with regard to the method of operation. This control is said by impartial authorities to deaden the activity of the companies. The State works one of the seven important systems. The concessions granted to the other six companies expire on various dates from 1950 to 1960. Of the railways of other countries, namely, Russia, India, Australia, Mexico, Italy, Holland, the Union of South Africa, Rumania, Poland, New Zealand, and Norway, the one generalisation that may be made is that the return on the capital has not been high. In 1909 in Mexico the main railway lines were united in one corporation—the National Railways of Mexico. Since 1914 this system, and practically all

¹ Cf. *The Economic Development of France and Germany*, J. H. Clapham (Cambridge University Press, 1921).

the private lines, have been taken over by Government. In 1910 the Government lines of the Union of South Africa were merged into one system—the South African Railways, under the control of the Union Government. In Belgium in 1919 there were 2759 miles belonging to the State, excluding light railways, and private lines were 184 miles. In Hungary of 4493 miles of railways 1856 are owned by the State. In Switzerland in 1920 the State railways had a length of 3881 miles, and in Austria 2964 miles out of 4274 were operated by the State. About half of the single track in Canada is owned by the State under the name of the Canadian National Railways. In the Argentine 18 per cent of the railway mileage belongs to the State. Many of the railways in the Argentine have been constructed with the aid of British capital. In Brazil of the total mileage which belongs to the State 3980 were administered directly and the rest were farmed out. In Holland all railways are private. There is, however, one State company, but this is only so because the road is owned by the State.

Speaking generally, then, it may be said that in most countries the railways are owned by the State, and with the exception of the United States, Great Britain, and Spain are either (*a*) State operated or (*b*) operated by the State and by private companies with a varying degree of State supervision. There are very few countries in the world where State supervision is confined mainly, as in England, to the interests of public safety. In England the free system of railway building and management has resulted in progressive methods which have been copied in many other countries. At the same time there is the disadvantage that the public may be inadequately protected because the courts are unwilling to interfere, although in recent years, both in Great Britain and in the United States, there has been an increase in legislative interference with railways.

In railway finance rates are not determined by free competition. This does not and cannot exist, as this is not to the interest either of the companies or of the public. It produces an uncertainty with regard to rates which prevents stable prices; it assists unscrupulous agreements between competing lines with regard to rates by pooling or dividing the traffic, and the rates are made not on the principle of equal mileage, *i.e.* the rates proportionate to the distance, but according to movement expenses

and terminal expenses, *i.e.* freight pays its share of the terminal expenses independently of the distance and the mileage charged according to the length of haul. Rates are reduced where the increase of business makes it profitable, or kept high where such a low charge would be unprofitable or where business is not expanding. The theory of charging according to what the traffic will bear is, as Hadley points out, "an unpopular one because it has been misapplied by railway managers and made an excuse for charging what the traffic will not bear. Rightly applied, however, it is the only sound economic principle. It means taxation according to ability—that ability being determined by actual experiment."

There are two other important points which demand attention in the public domain of railways, and these are (1) the scheme of fixing rates in order to pay a suitable return on capital as fixed by the well-known American Act—the Transportation (Esch-Cummins) Act of 1920 amending the original (1887) Act to Regulate Commerce, and (2) the separation of the railway Budget from the general Budget.

The Inter-State Commerce Commission, under the Act of 1920, was instructed by the Congress to establish rates which would yield a net operating income sufficient to pay a fair rate of return upon the value of the railway properties held for and used in transportation. The rate was fixed at $5\frac{1}{2}$ per cent, with an extra half per cent for improvements chargeable to capital accounts (6 per cent in all) for the first two years. This applied to the railways as a whole, or to a group of railways, and not to individual railways in a group. The rate which yields 6 per cent to all the railways in a group may yield more than 6 per cent to some and less than 6 per cent to others. No relief is provided for railways which earn less than 6 per cent, but when more than 6 per cent is earned by a railway the excess is divided evenly with Government, the railway holding its proportion in a reserve fund, and the half which goes to the Government being used as a general railroad contingent fund to be administered by the Commission in assisting the weak railways by loans. The reserve fund created by a railway from its excess earnings is to be held for interest charges or dividends in lean years, but when that sum is more than 5 per cent of its property value, the excess over 5 per cent may be used for any lawful purposes. The grouping of railways

in America under this Act leads to economy. It has also led to a similar economy in Great Britain, where, under the Railways Act of 1921 (which came into operation in January 1923), all the railways are grouped into four systems, namely, (1) the London Midland and Scottish ; (2) the London and North-Eastern ; (3) the Great Western ; and (4) the Southern.

The question of separating the railway Budget from the State Budget was attempted in Prussia as long ago as 1878. The railways were too prosperous to allow the scheme to be achieved. In Italy, however, the railways have a separate Budget. In France the railway Budget, which is worked by the State, is treated as an "annexe" to the general Budget. In the South African Union Act it is provided that the railways of the Union shall be so operated that the gross receipts shall not be more than sufficient to cover working expenses, reserves, and interest on capital. If there is a surplus it is to be devoted either to improvements in facilities or reduction in rates. If, on the other hand, there is a deficit, rates and charges shall be increased to cover it. In Switzerland the Purchase Act provides that "the railway accounts shall be kept separate from the other federal accounts, so that the financial position of the railways can at all times be clearly ascertained, and that railway earnings shall be devoted only to railway purposes". The control of new railway capital issues and of railway tariffs, and the voting of the railway Budget are reserved to the Swiss Parliament, but any surplus of revenue after meeting working expenses, interest, and sinking funds is devoted to railway purposes. If the revenue fall short of expenditure, the State meets the deficit. In Japan the railway Budget is entirely separate. The railways, under the Act of 1909, have a separate capital account entirely distinct from the general account. As the official report says, "This financial independence has given very great convenience and facilities in the management of the Imperial railways, as, indeed, it has made the railway finance one of special character among all the special accounts created by the Imperial Treasury. In short, the change has made the railway finance a financial agency specially adapted for the management of railway business."¹ The Finance Minister of India, in his Budget proposals of the 29th February 1924, proposed a scheme by which a Budget, separate from the general Budget, will be achieved, the

¹ Cf. Cmd. 1512, 1921, p. 35 (Acworth Report on Indian Railways).

Government receiving (1) a sum sufficient to pay in full the interest on capital invested by Government in commercial lines; (2) an additional dividend of five-sixths of 1 per cent on that capital; and (3) in addition a share of one-fifth of any surplus earnings that may be secured. The railways, on the other hand, will have the right to retain any surplus over and above what they pay to the Government, and to apply it to railway purposes, first of all in order to create reserves, and then by issuing these reserves to improve the services which they render to the public or by reducing the prices charged for these services. The Government of India and the Legislative Assembly are to remain in complete control of the railway administration as at present, and at the same time the railways will become, in the words of the Finance Minister, "a real commercial undertaking managed on commercial lines".

In the chapter on expenditure in regard to the commercial finances of Government (Chapter IX., paragraph 3), the advantages of trade railways as commercial undertakings were discussed. It is, however, essential to point out that in many countries any money not spent by the end of the financial year lapses when the railway Budget forms part of the State Budget, and the railways thereby lose their unspent balances. That is a great hindrance to efficient management. There are, too, (1) the difficulty arising from the receipt of funds too late in the year, so that funds cannot be spent advantageously, and (2) the futility of undertaking such projects when the continuance of funds in the following year is uncertain. Could anything be more bewildering than the letter sent by the Indian Railway Board to the Great Indian Peninsula Railway Company in December 1920? It runs as follows:

I am directed to inform you that five lakhs have been allotted in the six months' estimates with a view to making a commencement on the construction of the Warora-Pisgaon Railway from Majri to Rajur. I am to request that you will make arrangements for construction to proceed as quickly as possible with preliminaries up to the limit of this allotment. There is no expectation at present of any money being available for this line in next year and work may have to be temporarily suspended.¹

In the Indian Budget of 1925 Railway Finance has, for the

¹ Cmd. 1512, 1921, p. 22.

first time, been separated from General Finance. In September 1924 the Legislative Assembly established that railways should pay annually a fixed contribution to general revenues, and if the net balance remaining to railways exceeded a fixed sum, one-third of this excess had to be handed over to general revenues.¹ The railways are run as a commercial concern to a degree that was hitherto impossible, and the taxpayer receives a contribution from the profits of capital invested in railways. The difficulty of distinguishing between a temporary and a permanent surplus (or deficit) in Budget accounts under this heading will be less than hitherto.

¹ The figures for 1924–25 are summarised thus : Net receipts from railways, 9·74 crores ; fixed contribution to general revenues, 5·09 crores : since the balance, 4·65 crores, exceeds 3 crores the Central Government receives in addition one-third of such excess, or 0·55 crore. Total amount credited to general revenues, 5·64 crores, leaving 4·10 crores for transfer to Railway Reserve. On 31st March 1933 the total capital at charge was Rs.8,77 crores (£657,938,000), and the net earnings of the railways in 1932–33 amounted to Rs.2731 lakhs (£20,482,000), showing a percentage of 3·1 on the total capital charge. The net gain to the Central Government from "Budget Lines" was Rs.5·2 crores in 1932–33. The payment of the contribution has been held in abeyance during the present trade depression.

CHAPTER XXXI

LOCAL TAXATION

1. GROWTH OF LOCAL TAXATION

IN the present century, especially since the War, the enormous growth of local self-government in almost every country of the world has given great importance to the subject of local taxation. There has been an insistent demand not merely from cities and urban districts but also from rural areas for greater services on the part of local government authorities. This is not unnatural owing to the change in men's ideas as to the sphere of local public effort in regard to the social services, especially education and sanitation, to the increase in the standard of comfort, one of the results of the considerable expenditure on the social services, and also to the change in the price-level in recent decades which has meant a revision in salaries, wages, and other costs which cannot be reduced in existing circumstances to any great degree. This has led, as never before, to a great growth in local expenditure and to an everlasting struggle on the part of local authorities to make both ends meet by raising additional revenue largely through taxation. The expenditure of local authorities, for example, in England and Wales in 1885 was less than £54 millions, in 1913–14, the pre-War year, it rose to £148 millions, while in 1931–32 it was as much as £435 millions.¹ In other words, there was an increase of £287 millions, or 194 per cent, in local expenditure in the short space of eighteen years. Similar large increases are to be found in the majority of all other countries of industrial importance. To meet the increased expenditure local authorities have been compelled to resort to increased taxation and to additional grants from national, and in federal constitutions from

¹ This is expenditure other than expenditure out of loans.

state or provincial, governments, and also to loans. At the present time the proportion which local taxation bears to total taxation is very considerable. It varies from one-third to two-fifths or even higher in the United States, Canada, New Zealand, Germany, and Japan, while in other countries such as Great Britain, Australia, France, Hungary, and Italy it is about one-fifth. Local self-government in the United States as in Great Britain is highly developed. Local authorities in the United States raised about 57 per cent of the total (Federal, state, and local) tax revenue, in 1933, while only 20 per cent was collected by the state governments. Local authorities raise proportionately more than in any other country. This is a contrast with India, where provincial governments are strong and local authorities, with rare exceptions, weak.

THE IMPORTANCE OF LOCAL TAXATION AS COMPARED WITH THAT OF
NATIONAL AND STATE OR PROVINCIAL TAXATION

Country	Year	Unit	National	Prov or State	Local	Total	% Local to Total Tax Rev
Great Britain	1932	£000	733,019	..	179,899	912,918	19·7
Australia .	1933	£000	56,158	37,324	21,614	115,614	18·6
Canada .	1932	\$000	275,053	92,551	251,204	618,808	40·5
New Zealand	1933	£000	17,891	..	11,362	29,253	38·8
Union of S. Africa .	1933	£000	16,163	3,714	890	20,767	4
United States	1933*	\$000 Frs	1,859,174	1,641,850	4,715,897	8,212,921	57
France .	1933	000	36,306,000	4,808,000†	8,739,000‡	49,853,000	17·5‡
Germany .	1931	000	6,634,000	2,809,000	4,698,900	14,141,800	33·2
Hungary .	1932	Pengos 000	804,527	..	176,022	980,549	17·9
Italy . .	1932	Lire 000	16,571,067	..	4,363,765	20,934,832	20·8
Japan . .	1932	Yen 000	974,258	255,240§	601,296‡	1,830,794	32·8

* Before the depression, 1929-33, the Federal share of the total was relatively greater than the local government's share relatively less. The figures for 1925 were (\$000): Federal, 3,130,649; State, 1,107,370; Local, 3,818,374; percentage of local to total taxation, 47. Cf. page 101, *Cost of Government in the United States, 1925-26* (National Industrial Conference Board, New York, 1927).

† Taxes of the Departments.

‡ Local Taxes.

§ Taxes by Prefectures.

2. SCOPE OF LOCAL TAXATION

The services administered by local authorities may be generally grouped under two main heads, namely, (i) national or onerous and (ii) local or beneficial. On the Continent the classification is somewhat similar—obligatory and optional. A third classification is that adopted by the British Departmental Committee on Local Taxation, 1912, which divided local administered services into (1) local services and (2) semi-national services, as the words “onerous” and “beneficial” had given rise to some confusion of thought in regard to the proper amount of assistance to be given to the local authorities by the State. In local taxation there are services of a national or semi-national nature which local authorities are required to undertake. They are really national services carried out in the interests of the community at large, or quasi-national services carried out more in the interests of the community at large than of any particular locality. Examples of this class are police, education, public assistance in regard to the able-bodied or unemployment relief, and the maintenance of arterial roads. The State has undoubtedly an interest in the efficiency of these services as to justify its support and supervision or even control in administration. The national or State government gives subventions or grants or permits additions to its own taxes on behalf of local authorities to meet at least a part of expenditure on these services. The remainder is defrayed from taxes or rates levied mainly upon real property, viz. land and buildings. In the United States the basis of rateable value is the capital value of the real property while in Great Britain it is the annual rental value, which is the rent which it might reasonably fetch excluding the tenant's usual rates and taxes less an allowance for the probable annual cost of upkeep, such as the cost of repairs and insurance. They are payable in England and Wales by the occupiers of the land and buildings and in Scotland, since the seventeenth century, half on occupiers and half on owners. The amount is determined by three factors—the cost of local services, the proportion of that cost borne by the national or State government, and the rateable value of all the property in the district. These national or quasi-national services are indistinguishable in principle from services which the central authority administers and of which it bears the entire

cost. It is for this reason that under the Local Government Act, 1929, the British Government gives large block grants to local authorities in relief of rates, not directly allocated to specified services. The Central Government has taken over under the Unemployment Act, 1934, from local authorities the responsibility of public assistance to the able-bodied between the ages of sixteen and sixty-five. If the Government does not undertake the administration of these services, then it gives grants for specified services to ensure that they will be carried out with efficiency as these services effect the community at large.

In regard to local services the principle of benefit rather than ability to pay is, as far as possible, employed. Lighting, the disposal of sewage, the removal of refuse, the supply of water, and the provision of parks are purely local services in so far as the benefit from these accrues to members of the particular locality and are not to any marked degree for the benefit of the community as a whole. These are, therefore, on a different footing from the other branch of the services of local authorities.

Whether we take the county or the borough in England, the *arrondissement* in France, the circle in Germany, or the county in Japan, we find a general similarity in administration—government by a council with an elected head, and also a similarity in functions performed. The services are usually divided into six groups : (i) education, including libraries, picture galleries, and museums ; (ii) public health, including water supply, drainage, conservancy, hospitals, maternity and child welfare, housing, town improvement, lighting, and the regulation of traffic ; (iii) roads, streets, and bridges ; (iv) public assistances, including the maintenance of asylums for lunatics and defectives ; (v) police, including prisons ; (vi) agriculture, including rural industries, diseases of animals, pests, fertilisers, small-holdings, and allotments. In a few countries some of these functions only are performed, in others there are additional functions such as the collection of taxes, elections to the legislature, the registration of electors, the administration of insurance schemes and of old age pensions. In many countries, as in Great Britain, the State undertakes the control of the police force and contributes towards its upkeep, while the maintenance of the force devolves on local authorities. In France the State undertakes the maintenance of the general police force of the country and the local police

authorities the rural police. In Japan, however, the police is paid by the prefectures and no part of it is borne by the cities or towns and villages. In India the police is paid for by the provincial governments except in areas directly under the Central Government.

To meet the services provided by local authorities taxes are levied, usually on land and buildings. In France and Japan the main source of taxes is surcharges on national and prefectoral taxes, and in France also octrois and taxes in place of the octrois duties, road taxes, revenues from public utilities, as well as income from common funds belonging to the communes. There is, on examination, greater similarity in most countries in the sources of local revenue than at first would appear to be the case. Thus in Belgium, Italy, Spain, and Germany supplements to national taxes as well as shares in national taxes are a very large source of revenue to local authorities. In Belgium for the year ended 31st October 1933 local taxation was derived to the extent of 244 million francs from shares in national taxes and to the extent of 515 million francs by supplements out of a total local taxation revenue of 760 million francs. In Italy supplements to the house and land tax amounted to 1307 million lire out of a total taxation of 4243 million lire in 1932. In Spain supplements to national taxation for the year ending December 1933 were 81 million pesetas and the share in national taxes 45 million pesetas out of a total of municipal taxation amounting to 143 million pesetas. Local taxation in Germany was mainly from real estate and occupational taxes, 30 and 16 per cent respectively, 21 per cent from income and local citizens' taxes, 10 per cent from rents, 10 per cent from general and selective sales taxes, 4 per cent from motor vehicles, 6 per cent from beverage taxes, and the remainder from miscellaneous taxes such as the slaughter tax and the amusement tax. In Great Britain and in the United States we have the taxation of real property to an outstanding degree. The general property tax is the mainstay of local authorities in the United States. In the United States, too, there are poll taxes, taxes on corporations, and special taxes on insurance companies and banks, telegraphs, telephones, gas and electricity companies, and the taxation of vehicles and motor fuel or gasoline. The last of these is very

productive. Local authorities in nearly all countries have recourse to property as the main source of their tax revenue. This adverse differentiation against property is the result usually of historical causes, but administrative convenience may be said to have been the chief motive underlying the imposition of the tax or rate. In the United States the general property tax is far and away the main source of local authorities' revenue, but, in recent years, the taxation of gasoline, motor vehicle registration, and taxes on corporations have brought in greatly increased revenues, notably in New York, Pennsylvania, New Jersey, and Massachusetts. Special assessments in American municipal finance have now become important as a means of paying for the large improvements which cities find it necessary to undertake. In the United Kingdom the main sources of local taxation are buildings and land and grants from the National Government. In Canada, as, for example, in New Brunswick, there is a general property tax, a poll tax, an income tax, and fixed licences on auctioneers, non-residents, pedlars, and transient traders. In Nova Scotia local taxation includes the taxation of real and personal property and a poll tax, a dog tax, licences to traders and special annual taxes on insurance companies, banks, cable and terminal companies, together with a household tax, the basis of which is 10 per cent of the value of the house if valued at \$1000 or over. There is also an income tax for local purposes, the assessment for which is very unsatisfactory. In Australia property is the main source of local revenues. In Western Australia, for example, the rate varies according to the requirements of the locality and is levied on the annual rental value of the property less 40 per cent. There is also a tax from 3d. to 2s. in the pound on the unimproved value of land or annual value for the upkeep of roads. In Queensland there is also a general rate up to 1s. in the pound on the unimproved value of land. In Tasmania land is taxed for local purposes from 1s. 6d. in the pound to 5s. 3d. and improvements from $7\frac{1}{2}$ to $26\frac{1}{4}$ per cent, the rate—not a graduated tax—varying according to the locality. In many cases the taxes are supplemented by licences such as dog taxes and licences on motor vehicles. Municipalities in Sweden under the General Municipalities Tax Law tax real estate and income. There are in addition a road tax, a dog tax, an amusement tax, and an excise duty on wood when the timber is

cut. In Italy the communes levy taxes on wine, milk, perfumes, soaps, and other articles of consumption, including gas and electricity. Octrois are since 1923 levied by communes. Up to 1923 the Italian Government received a share in octrois, but from September 1923 communes were given the sole right to levy duties in lieu of Government subsidies. There is a house tax based on the rental value of the house. A family tax based on the total family income rising to a maximum of 8 per cent. Taxes are levied in the form of licences for hotels and dance-halls, domestic servants and animals, and on professions and on public notices. There is a tax on the unearned increment following public improvements and the expansion of population, but manufacturing areas are excluded. In India, where local self-governments' financial resources are quite inadequate, property is the basis of much taxation together with taxes on professions, trades, and callings, octroi duties, terminal taxes, taxes on vehicles, and fees from public undertakings such as water supply and the removal of sewage and refuse. An "additional" tax is permitted on the land revenue or tax—the proceeds going to the District Local Boards. It is usually limited to $6\frac{1}{4}$ per cent, although in Bombay the Local Fund rate may be raised to a maximum of $12\frac{1}{2}$ per cent. Taxes on unearned increment are levied under the Bombay and Madras Town Planning Acts and under the Rangoon Development Trust Act. The incidence of local taxation even after taking into account the low *per capita* income is light as compared with local taxation in most other countries. Glasgow, for example, contains the same population as that of Calcutta but it has twelve times its income.

There are shared revenues as in Great Britain, France, the German Reich, and in the Commonwealth Governments of the United States. Local authorities are entitled to obtain a share of the national taxes. In addition permission is, as we have seen, granted in some countries to local authorities to impose a percentage addition on both national and State taxes, departmental or prefectorial taxes.

Local receipts may be conveniently grouped under the following heads: (i) taxes on real property (land and buildings); (ii) taxes on industry and trade and on industrial callings and professions, such as the taxation of corporations in the states of the American Union and the taxation of professions, trades, and

callings in many countries ; (iii) taxes on imports and exports (octrois and terminal taxes) ; (iv) the taxation of special articles such as gasolene, motor cars, beer and articles of consumption generally ; (v) a special tax on site values ; (vi) grants from the State Treasury either in the form of a share of the total cost or in the form of a block grant fixed for a period of years or in the form of a share of the national revenues ; (vii) an addition to national or provincial taxes ; (viii) a tax on public utilities by charging for public utility services in such a way that profits are made and used for the relief of rates ; (ix) miscellaneous sources. All of these classes of revenue may not be used at the same time and they vary from country to country and from locality to locality.

It is necessary to comment briefly on several of these forms of local taxation. The property tax in the United States for local purposes is levied by countries, cities, towns, school districts, and similar local authorities over which is the State or Commonwealth Government. The general property tax is the principal source of revenue of local tax authorities as it is of the State Governments, and the proceeds of the tax are used for both State and local purposes, except in one or two states such as Pennsylvania, North Carolina, and California, where it is not used for State but only for county purposes. The importance of this tax may be seen from the fact that in 1926 one-fourth of the total State revenue was from this source and from one-half to two-thirds of all the revenues of cities with a population of 30,000 or over. In the same year cities with a population of 30,000 and over—250 cities in all—in the United States obtained 63·8 per cent of their revenues from the general property tax as compared with 10·2 per cent from public utilities and 7·5 per cent from special assessments, 4 per cent from subventions, 2·9 per cent from licences, and 11·6 from other sources, tax and non-tax.

The property tax dates from the early Colonial period when it was necessary to provide funds for common purposes such as roads, bridges, or school buildings. In its early history the tax may have been a fair index to ability and suited to the social conditions of the time. The main principles underlying the general property tax then were : (1) that the individual should pay to the support of the Government in proportion to his ability, and (2) that property in general, viewed as a whole, was the

measure of the individual's ability to pay. In its early history the tax was found to be equitable and suited to social conditions. The assessor counted up the various forms of property, land, houses, cattle and furniture, and valued these various items. At first it was arbitrary, but in time corresponded in the main with the market price or capital value of the property. With the development of social and economic conditions it was no longer an adequate measure of ability to pay, and earnings, rents of land, and products of individual effort were taxed. In the tax law of Ohio, 1846, for example, we find : " All property whether real or personal within this state and all monies and credits of persons residing therein unless exempted shall be subject to taxation "¹. By the middle of the nineteenth century the tax had thus become a personal tax. Owing to the development of property in its various forms, such as stocks, bonds, mortgages, etc., the tax became less and less personal. The tax imposed at present, however, by local authorities is generally a tax on tangible property, i.e. a tax on all real estate within the taxing area and on such tangible personal property as can be found. In many states intangible property is also taxed, but as this property is also separately taxed there is double taxation. Owing to the nature of the property it often leads to very considerable evasion. Nearly 85 per cent of the tax is on real estate and other tangible property.

For the administration of the tax each state is divided into assessment districts which vary in size. In New England the township is the district, while in Virginia it is the county, and in cities it is usually the ward. The assessment roll or list showing every form of real estate is prepared afresh every year and the necessary changes in the ownership of personal property are made. The assessed value is not always the market value of the property. In Chicago, for example, real estate for assessment purposes is valued at about one-quarter of its market value. Buildings are not always valued separately, but a lump sum is put down for the land and buildings. The valuation figures are used ordinarily for both city and county purposes, and also for the state where the property tax is levied for state purposes. Valuable lessons are to be learned from the American system of valuation, especially that in force in New York. Speaking generally, it may be said to illustrate all the faults likely to

¹ Quoted by Lutz, *Public Finance*, p. 322.

arise from putting into untrained hands a difficult and technical matter. Sometimes the method of valuation is not uniform even in the same city. "How the assessor arrives at this value is known only to himself. Although the laws usually stipulate that he shall assess property at its fair market or cash value, and thus give him a quasi-judicial duty to perform, the average assessor often sets up his own standards in violation of this statutory instruction. He begins, as a rule, by taking the values set by his predecessor upon the properties, and then proceeds to raise or lower these or to leave them as they were. Sometimes the assessors follow the general policy of making all valuations low in order to attract industries to the city or to ease the burden of State and county taxes. Sometimes, on the other hand, they try to raise assessments all along the line in order to keep the nominal tax-rate down or to enhance the city's borrowing power when this is fixed in terms of total valuations. Some assessors arrive at a value for buildings by estimating what an owner could get for both land and buildings, and then deducting what he could probably get for the land alone; others estimate the original cost of the buildings, less depreciation; others, again, try to set down the reproduction cost. Although uniformity in such things is what statutes require and what fairness demands, there is usually no approach to it among different cities of the same state or sometimes in different parts of the same city."¹ In New York city, however, a very elaborate system of classification of buildings according to type, cost per square foot of floor space, etc., is used, and other tests such as the price at which a building of this class was sold, or current rental values, are also taken into consideration as checks. New York has found this scientific method both practicable and remunerative.

The rate of the tax is expressed in the form of so many mills on the dollar of assessed value. The most common way of determining the millage is the same as in Great Britain, *i.e.* the total amount required for the year is divided by the total of the assessment roll. Another method is to fix the rates for different items of expenditure such as 5 mills for schools, 3 for roads and so on,

¹ Munro, *Principles and Methods of Municipal Administration* (New York: The Macmillan Co., 1920), p. 415. In assessing personal property under the property tax the assessors usually fix a sum which will be paid without protest or appeal to higher authorities.

and every activity confines its expenditure as far as possible to the amount thus produced. In certain states the tax raised is a combination of different rates levied by the various authorities. Property in a state, for example, may have had to bear 30 cents as a state tax, 50 cents as a county, 75 as a city or town, and 25 cents as a school district tax. Education is usually financed from property taxes, but also from income taxes, poll taxes, inheritance taxes, sales taxes, and severance taxes, the last of which are taxes on mineral production and on other products severed from the soil. Most of the charges for education falls on property taxes for the upkeep of the State School Fund and for State Universities. A few states, however, do not definitely earmark taxes for educational purposes, although they provide often relatively a larger proportion from state tax sources and schools than do those which provide a claim on special revenues. In the case of large corporations such as banks, insurance companies, railways, etc., it is not, as we have seen, an easy method to assess them for local purposes. Hence they are assessed wholly by the States Tax Commission, and either the state appropriates the entire proceeds of the tax or the assessments are apportioned to the districts. Property used for religious, charitable, and educational purposes is exempt from taxation generally. It is usual to grant an exemption of a certain amount of furniture, household goods, tools, etc. The taxpayers can appeal to a Board of Review or a Board of Equalisation if they consider that they have been too heavily assessed. The Board consists usually of the County Governing Board or a Board of City Fathers.

The general property tax is to be condemned on account of its theoretical and practical defects. It does not accord with the principles of a good tax. It lacks uniformity, it is regressive, leads to double taxation and evasion. As Leroy Beaulieu says,¹ “Rarement dans la fiscalité moderne on a inventé d'instrument plus grossier”.

Poll taxes and special assessments are to be found side by side with these property taxes and also licence taxes on businesses or occupations. Special assessments for cities have been dealt with elsewhere.² Special assessments have been found to be a convenient method of raising revenues owing to the fact that the

¹ Cf. Leroy Beaulieu, *Science des finances*.

² Chapter XIII.

construction of local improvements has increased the value of neighbouring property. Special assessments are, of course, levied only on those who benefit from improvements. They are levied on property owners only and are justified by the fact that they give at least an equivalent value to the owner of the property. They are, too, excluded from general tax rate limitations and therefore are popular. Expenditure can always be paid for by special assessments, and these assessments manage to bring in to the net of local taxation property exempt from state and general taxation, such as that belonging to educational, religious, and other institutions, since these are not exempted from charges which give a corresponding increase in the value of the property improved.

The importance of local taxation in the United States may be gauged by taking at random samples of the relation between state and local collections. In Mississippi for 1933, the state collections amounted to \$9.8 millions as compared with \$23.6 millions in the case of county taxes. The general property tax for state purposes amounted to \$3.7 millions, while in the case of county taxes the general property tax amounted to \$15 millions. The other county taxes were poll and road taxes \$0.6 million, a gasoline tax \$6.0 millions, and automobile licences \$1.8 millions. In this same year in Pennsylvania the state taxes amounted to \$112 millions, while local taxes (general property collections) amounted to \$338.8 millions. In New York in 1932 the general property tax amounted to \$831 million dollars out of a total state and local revenue of \$1087 millions. The next important heads of revenue were the personal income tax \$41.7 millions, the gasoline tax \$40.3 millions, the registration of motor vehicles \$38.2 millions, the franchise tax on business corporations \$36.9 millions, the inheritance tax \$36 millions, and the stock transfer tax \$22.7 millions.

English local finance has grown up haphazardly under the influence of particular exigencies of the moment. Thus the Poor Law legislation of Queen Elizabeth in 1601 formed the basis of local taxation up to within recent years, and its influence has been so great that it will not easily, if ever, be obliterated. Under the Act of 1601 each parish was required to provide for the relief of the poor, and the money required for this purpose was raised by taxation "of every inhabitant, parson, vicar, or other", and of every occupier of lands, houses, tithes, coal mines, or saleable

underwoods. The rate was paid by the occupier in respect of immovable property on the basis of "competence", and the rent or the net annual value was taken as the measure of rateable value. Other rates in the course of time were assimilated to the poor rate, and various administrative changes took place between 1888 and 1929, when the Local Government Act was passed. The Rating and Valuation Act, 1925 (which came into force in April 1927), and the Local Government Act, 1929, were essential because there were many anomalies, defects, and a considerable overlapping of services. The former Act consolidated all rates and simplified rating machinery. The council of every county borough and of every urban and rural district was constituted the rating authority for the borough or for the county district concerned. The rating authority in each county, borough, and urban area was empowered by this Act to levy a consolidated rate termed the General Rate, which replaced the poor rate and any other rate or rates previously levied. By the Act of 1925 Overseers of the Poor were abolished. This redistribution or regrouping of local subdivisions was long overdue. It was necessary in order that local authorities could more efficiently discharge their duties by an enlargement of the subdivisions. The Local Government Act, 1929, completed the reforms required to remove further objections to rating. As long ago as 1885 the English system of local taxation had been described as "A chaos of areas, a chaos of franchises, a chaos of authorities, and a chaos of rates". The rates varied from district to district and were particularly heavy in poorer districts. A good instance of overlapping was the case of the 625 Boards of Guardians which had their own separate hospital in spite of large and well-equipped hospitals under the administration of the County Councils. The burden of taxation varied owing to the burden of unemployment being heavier in some areas than in others. One remedy was to transfer the functions of the Boards of Guardians to larger bodies—the County Councils. Just as the Poor Law Commission of 1834 resulted in the area of administration being enlarged from the parish to the union, the Act of 1929 enlarged the area from the union to the county. In the matter of roads the same principle applied, as it was necessary to have the administration entrusted to larger areas, the County Councils of rural and urban districts. The Act, in short, enlarged the area of administration and made the

machinery more efficient to prevent the considerable diversity of rates which up to the passing of the Act then prevailed. Industry was relieved of part of the burden of local rates by the de-rating of certain properties. Industrial and mining properties were rated at one-quarter their assessable value and railways were rated also at one-quarter their assessable value, but the money saved in the latter case was to be devoted wholly to the reduction of freight charges on certain classes of goods. Agricultural buildings and lands were under the Act entirely exempt from local rates. The Central Exchequer undertook the vast expenditure on Poor Relief and Highways to a more equitable degree by means of grants.

The system of grants in Great Britain is of special interest and importance. Before 1888 the grants-in-aid of particular services were given annually by Parliament from the National Exchequer to local authorities. These grants were appropriated to certain objects, as, for example, half the cost of pay and clothing for police and of salaries of Poor Law officers. Under Lord Goschen's scheme of assigned revenues these direct grants-in-aid were abolished and the proceeds of certain taxes such as local licence duties as well as 50 per cent of the proceeds of probate duty were allocated to local authorities. In 1894, on the abolition of the probate duty, an increasing sum was granted from the estate duty. The receipts of these assigned revenues were paid into a fund called the Local Taxation Account and were distributed in such a way that each authority received the licence duties collected within its jurisdiction, and the proceeds of the estate duty and sur-taxes on beer and spirits which were added subsequently were distributed in proportion to the discontinued grants received by each local authority in 1887-88. In addition to these grants, percentage grants were given, as, for example, in respect of the expenditure under the Agricultural Rates Acts of 1893 and 1923. The criticisms of the Geddes Committee on National Expenditure¹ in connection with percentage grants are so apposite that they deserve quotation *in extenso*:

The advantage claimed for the percentage grant system is that it provides a stimulus to authorities to improve the efficiency of their services ; in fact, it is a money-spending device.

The vice of the percentage grant system is that the local authority, which alone can really practise economy in these services, loses

¹ Cmd. 1581 (1922), pp. 105-6.

much of its incentive to reduce expenditure, especially when the larger proportion is paid by the taxpayer through the Exchequer. The deciding voice as to what money shall be spent is not that of the Government or the House of Commons, but that of the local authorities. The Departments are thus in great difficulties in framing estimates, for these are based on anticipations not of what the Department itself will do, but of what hundreds of local authorities may do. The weakness of divided responsibility is manifest throughout.

If the Government were to attempt to impose a real and effective check from the point of view of efficient administration as well as audit, it would result in an enormous increase in bureaucratic control. It would mean a detailed scrutiny of accounts and an examination of all new expenditure. This would tend to overload the central machine, diminish local responsibility, and lead to greatly enhanced administrative cost. We do not suggest that the local authorities are negligent, nor do we suggest that they have not been directed to incur expenditure in conformity with a policy which, if left to themselves, they would not have incurred. We consider that the percentage grant should be abandoned in the interests of economy and be replaced by fixed grants or by grants based on some definite unit. Even though it were necessary to maintain the charge to the taxpayer at its present very high level, which we do not admit, the change would still, in our opinion, be very beneficial to the country by :

- (i.) Increasing the incentive to local authorities to economise.
- (ii.) Restricting the growth of the demands on the taxpayer.
- (iii.) Enabling staff economies to be effected at headquarters.

In the case of the grants to local authorities for housing purposes, the system adopted has gone even beyond the percentage grant at its worst. Here the local authority has lost all financial incentive to effect economy, because the annual loss in excess of a 1d. rate, say, $\frac{1}{5}$ ths of the total, is entirely at the cost of the taxpayer. Here we have a vast partnership in a property. The managing partner, viz. the local authority, has absolutely no financial incentive to economy, as no saving he effects redounds to his own benefit. The taxpayer, through the Exchequer, pays the whole excess, which is estimated at 10 millions a year for sixty years.

The principle of giving grants according to the needs of the locality is to a certain extent seen in the case of grants under the Education Act of 1918. The grant consisted of (i) a capitation grant with varying percentages in regard to different classes of approved expenditure ; (ii) a deficiency grant in case the substantive grant fell short of the total net cost ; (iii) a high rated

area grant in the localities where the education rate was in excess of 3s. 6d. in the pound or one-half the excess. But the system of rating generally until the reforms of 1929 was anomalous. That system did not take into account the requirements of a particular locality or its ability to meet these. They were based particularly in the case of percentage grants on expenditure and tended to give most to the areas which were richest and spent most, while the remaining grants rested on an arbitrary principle of division stereotyped in most cases many years previously and therefore completely out of date. The borough of Middlesbrough, for example, received 26 pence per head, whereas Hastings got 109 pence. The Act of 1929 provided for the discontinuance of miscellaneous grants, including the percentage grants for health services, maternity, and child welfare, as well as for the maintenance of the scheduled roads. It replaced them by an "all in" block grant which is revised at the end of every quinquennium. The absurdly clumsy machinery of the old taxation account is dispensed with. The block grants leave greater freedom to local administration and they ensure a greater degree of responsibility by leaving the burden of extravagance to fall directly upon the ratepayer. The principle of calculation is simple. It is calculated on a capitation basis taking into consideration various factors so as to make it larger for the poorer and distressed areas where expenditure is necessarily heavy. The rateable value per head of the locality is taken into consideration in judging its richness or poverty. The rateable value cannot indicate the expenditure which an authority is required to meet, and therefore allowance is made for the following three factors : (i) the number of children under five years of age per one thousand of the population ; (ii) the percentage of population unemployed ; (iii) the population per mile of public road. Usually the last factor is significant in rural areas where highway services absorb a larger percentage of local expenditure. These factors are combined into a formula so as to widen the capitation basis upon which the grant is calculated. The formula on which the distribution is based is briefly as follows :

Let p = the population of a county in the standard year.

$c = 50$ or the number of children under 5 per 1000 of the population, whichever is greater.

Let $a = 10$ or the rateable value in the pound per head of population according to the valuation list in force on 1st October 1929, whichever is the less.

$m =$ The number of persons per mile of public road.

$u = 1.5$ or the percentage of unemployment, whichever is the greater.

Then (1) if m is greater than or equal to 100 the weighted population is,

$$p \left(1 + \frac{c - 50}{50} + \frac{10 - a}{10} \right) \left(1 + \frac{u - 1.5}{10} + \frac{50}{m} \right),$$

or (2), if m is less than 100,

$$p \left(1 + \frac{c - 50}{50} + \frac{10 - a}{10} \right) \left(1 + \frac{u - 1.5}{10} + \frac{200 - m}{200} \right).$$

The scheme is made to work out gradually. For the first five years beginning with the year 1930 three-fourths of the grant was based on the existing distribution and only one-fourth according to the new formula. The proportion was so increased that at the end of fifteen years the whole grant will be distributed on the new basis. The interests of local authorities are safeguarded by a guarantee that the ratio of the Exchequer contributions to the rate-borne expenditure of a county will be maintained at a more or less constant level. The importance of the new scheme can best be appreciated when we remember that in 1926-27 the total expenditure of local authorities from Government grants and rates was 29 : 53, whereas under the new scheme it would have been in that year 29 : 32. The block grant is supplemented by a special subsidy, if necessary, for needy localities, provided proper safeguards exist, and it secures a minimum standard of service without imposing a heavy burden on any locality. It also gives a considerable measure of autonomy without encouraging extravagance, and it provides for economy and enterprise. The relative importance of the grants-in-aid and of the block grants not allocated to specified services may be seen from the following table, which shows the direction of expenditure and the method by which it is met :

LOCAL TAXATION—ENGLAND AND WALES, 1931–32
(£ millions)

Item	Current Expenditure	Specific Income		Balance provided from Local Rates
		From Fees, Tolls, Dues, etc	Government Grants	
1. Trading services (tramways, water-works, gas-works, electricity supply, harbours, other trading services)	117	113·1	2·7	1·2
2. Education . . .	85·1	4·1	42·1	38·9
3. Highways and bridges .	51·9	–5	18·9	38·0
4. Poor relief . . .	30·4	2·1	..	28·3
5. Police . . .	22·3	0·9	10·6	10·8
6. Housing schemes .	40·1	24·7	12·3	3·1
7. Public health . .	45·1	5	1·5	38·6
8. Mental hospitals and mental patients	10·8	2	..	8·8
9. Others . . .	32·3	10	2·3	20
10. Grants in relief of rates (not directly allocated to specified services)	..	..	46·5	..
TOTAL . . .	435	156·9	136·9	187·7

NOTE.—(1) Expenditure out of loans for capital works are excluded; (2) figures in columns 3 to 5 are adjusted so that the total of each item equals the figure of expenditure under each head in column 2. Grants in relief of rates not directly allocated to specified services were in 1931–32 £46·5 millions, and should be deducted from the totals of columns 3, 4, and 5, to arrive at the same total as in column 2, viz. £435,000,000.

Wagner criticised the English system of local taxation when he pointed out that “British local taxation excludes duties on articles of consumption, and hence it appears not better, but rather still more one-sided. The exclusive use of direct taxes is a defect. The English system can in no way be regarded as an example for the Continent.”¹ The German author considers that the simple British system of a rate on the annual value of real property is inadequate. It is suitable for that part of local taxation which confers special benefits such as on the owners of fixed property, but for expenditure on education and other national objects, which confers a benefit on no one in particular, he believes the burden should be distributed otherwise, in order to secure equality of sacrifice, for example, by an additional rate on the

¹ Wagner, *Finanzwissenschaft*, vol. iii. § 164.

State income tax *Zuschläge* (like the *centimes additionnels*) or by indirect taxation like octrois. Wagner's criticism regarding the large importance of the direct taxation of property in England for purposes of local taxation, is of course a fair one, but had he been alive to-day he would have been the first to appreciate the manner in which this has been rectified by the centralisation of certain services and by the new system of block grants in relief of rates. It is true that there are several avenues open to local authorities in taxing which on the Continent are practised, such as duties on articles of consumption, but the taxation of business has never been popular in Great Britain for local purposes and octrois would never be possible. The taxation of petrol or gasoline, vehicles, and amusements is centralised by the National Government, but although adopting this as a national and universal form of taxation it returns in the form of grants to local authorities a considerable amount of the revenue which abroad would be looked on as suitable for communes and other local authorities. Another critic thinks that too often stress is laid on the independence which the English method is supposed to secure to local authorities, "I confess myself entirely unable to appreciate the weight of this argument. Why should it be more independent to impose 1d. per £ on all rentals in the assessment roll, than to pay 1 per cent on all incomes detailed in the 'Kadaster'? The argument that French and German decentralised Governments are kept in leading strings by *centimes additionnels* and *Zuschläge*, while in England they strike out freely a line of their own, seems to me to be empty rhetoric."

In Germany most of local tax revenue is derived from taxes on land, buildings, and business. Local income taxes are no longer popular, because they are unsuitable for local purposes and interfere with the federal tax which the states and localities now share. Public undertakings are run for profit, which reduces the direct tax burden of the locality. This is in contrast with similar undertakings in Great Britain, which are operated on minimum charges for the service. Any profit from these which is transferred to the relief of rates is regarded as an indirect tax. The position of local taxation may be gauged from a survey of the Prussian local tax system. Prussia is not far short of two-thirds of the total area and population of the Reich. There is in Prussia the local supplement to the land

tax. The rate is expressed as a percentage, based on the need of the community or local authority, and averages 300 per cent of the State tax without the 100 per cent surcharge which exists in the case of the State land tax. The house tax, which it is intended to discard gradually by 1940, is shared with the local communities. The State keeps a fixed amount, 50 million marks ; and of the remainder 53 per cent is kept by the State and the balance, 47 per cent, goes to local authorities. In addition to these property taxes there are other taxes. There is a business tax which is levied by the local board of assessment, established in urban or rural districts, on the properties of business undertakings. The rates vary, but on an average for the profits tax the percentage increases are 500 if based on profits, on capital 1000 per cent, and on wages 1600 per cent. These were the rates on 1st January 1933. Practically $82\frac{1}{2}$ per cent of local revenues in Germany are from real estate and occupational taxes, income and property taxes, and taxes on rents. The remainder, $17\frac{1}{2}$, is from general and selective sales taxes. The local tax on business is fixed by the local board of administration either on capital used in the business (*Kapitalsteuer*) or on the sum paid out as wages by the business (*Lohnsummensteuer*). The tax on itinerant stores or stocks of goods is levied by the local board of assessment. The personal tax based on the amount of annual income is collected locally for the use of local communities. The tax depends upon the income. Employers withhold the tax from wages and pay it to the local collecting agency. Similarly the tax on increments in the value of real estate, the amusements tax, the local beer tax, the liquor tax, the dog tax, the tax on hunting, and the tax on liquor permits, are assessed locally for the use of the local authorities. The table on next page shows the distribution of local taxation in the German Reich.

It will be seen that local authorities obtain their revenue mainly from direct, but also, to a greater degree than is supposed, from indirect taxation. A large share of local taxation is derived from shares on the national taxes. Some taxes are levied by local authorities themselves and include the following : real estate taxes, occupational taxes, taxes on rents, taxes for the encouragement of building construction (*Bauanteil*), the increment of value tax (*Wertzuwachssteuer*), the local citizens tax, (*Bürgersteuer*), the tax on motor vehicles, the amusement tax, and the dog tax.

TAX REVENUE IN GERMANY (1932-33) : LOCAL TAXATION COMPARED
WITH NATIONAL AND STATE TAXATION¹

	Local.	State	National (Million Marks)	Total
Customs duties . . .	..	..	1106	1,106
Income and Property taxes	676.9	512	1138.9	2,327.8
Real and Occupation taxes	1432.2	515.9	..	1,948.1
Taxes on Rents . . .	373.7	511.6	..	885.3
General and Selective Sales taxes	309.4	262.8	1115.4	1,687.6
Transportation taxes . . .	123.8	36.6	185.9	346.3
Consumption taxes . . .	266.5	208	1425.3	1,899.8
Equalisation fee . . .	9	..	..	9
TOTAL . . .	3191.5	2046.9	4971.5	10,209.9

There are other sources of revenue such as communal property, fees, special assessments, and public utilities. State governments are alive to the necessity of working municipal undertakings with as much profit as possible, and some of the best public undertakings in the world are to be found under the control of local authorities, especially municipal corporations in large cities.

The first sections of the Prussian Communal Taxation Act of 1893, the *Kommunalabgabengesetz*, usually known as the "K.A.G.", laid down principles which still hold good. The first sections of the K.A.G. provide that:

(1) "The communes are authorised, in order to cover their expenses and meet their needs, to collect in conformity with the conditions of this present law fees (*Gebühren*) and special contributions (*Beiträge*), indirect and direct taxes, and to demand personal services."

(2) "The communes must use the power granted to them of collecting taxes only in proportion as their revenues, and especially the product of the communal domain, as well as the resources put at their disposal by the State or the higher local authorities, are not sufficient to cover their expenses. This restriction does not apply to the taxes on dogs, on articles of luxury and other analogous objects."

(3) "Industrial enterprises undertaken by the communes

¹ *Statistisches Jahrbuch für das Deutsche Reich*, 1933. Cf. *Tax Systems of the World* (Chicago, 1935), p. 348.

must, as a general rule, be administered so that the receipts may at least balance the expense incurred by the communes in connection therewith, including interest and sinking fund."

In France direct taxation forms 70 per cent of the total revenues. Indirect taxation amounts to 17 per cent, excluding octrois, which amount to 12 per cent. The French system of control is of interest because of the powers which the prefects as head of the prefectures wield. They can annul the decision of a municipal council; they may suspend any official, the mayor not excepted; the whole council may be suspended by him, and with the approval of the Minister he may dissolve it. Considerable revenues are obtained from *centimes additionnels* on State taxes. Sixty per cent of the taxes of the Departments in 1930 were surtaxes on State revenues—*centimes ordinaires* 48 per cent and *centimes extraordinaires* 12 per cent. Similarly not far short of one-third of the local taxes are obtained from surcharges. The following tables show at a glance the sources of local taxes in France:

TAXATION IN FRANCE OTHER THAN "NATIONAL"¹

Taxes of the Departments, 1930

	Million francs
<i>Centimes Ordinaires</i>	2318
<i>Centimes Extraordinaires</i>	598
Relief fund receipts (<i>ressources ordinaires pour l'assistance</i>)	1171
Road receipts (<i>ressources ordinaires pour la vicinalité</i>)	314
Share in common funds and national taxes (<i>parts sur fonds communs et impôts d'État</i>)	247
Miscellaneous receipts (<i>recettes ordinaires diverses</i>)	113
Departmental fees (<i>taxes départementales</i>)	45
Licence fees (<i>produits des droits concédés</i>)	2
TOTAL	4808

Local Taxation, 1929

	Million francs
<i>Centimes additionnels</i>	2416
Octrois and taxes in place of the octrois	1269
Share in the common funds (<i>participation aux fonds communs</i>)	768
Revenues from public utilities	547
Road tax or payments in kind (<i>prestation ou taxe vicinale</i>)	532
Fees for stands (<i>droits de stationnement et location</i>) (166); for the privilege of place (<i>droits de place</i>) (163); toll and surveying fees (<i>droits de péage mesurage et</i>	354

¹ SOURCE.—Table compiled by the French Ministry of Finance. Cf. p. 348, *Tax Systems of the World* (Chicago, 1935).

	Million francs.
<i>jaugeage) (22); documentary fees (<i>droits de expedition des actes administratifs et de l'Etat Civil (3e)</i>)</i>	
Municipal excises (<i>produit des régies municipales</i>)	298
Miscellaneous taxes (<i>taxes diverses prévues par la loi du 5 avril 1884</i>)	210
Taxes authorised by law of August 13, 1926 (<i>taxes autorisées par la loi du 13 août 1926</i>)	209
Share in the price of cemetery concessions	91
Taxes on electricity and gas consumption	70
Taxes on slaughtering and on meat stamping	62
Mining dues (<i>redevance des mines</i>)	53
Dog tax	31
Tax on balconies (<i>taxes sur les balcons et saillies</i>)	16
Amusement tax	15
Miscellaneous revenues (<i>recettes ordinaires diverses</i>)	1798
TOTAL	8739

It will be seen from this table that a large proportion of local taxation is obtained in France by imposing additional percentages or surtaxes on the national taxes. This practice is followed, as we have seen, by the *Länder* (or States) and the *Gemeinden* (or local authorities for communes) in Germany. It is in use in Belgium to-day, as, for example, in the case of taxes on income from personal property (*taxe mobilière*), the tax on income from occupations (*taxe professionnelle*), the amusement tax, the tax on gambling and betting, and some miscellaneous taxes. In Japan no less than 52 per cent of the taxation of prefectures is obtained from supplements on surcharges and 35 per cent in the case of local authorities. This will be seen from the following table, which gives the details of the local taxation in Japan :

TAXATION IN JAPAN OTHER THAN NATIONAL¹

Prefectures, 1933

1. Supplements to—	Million Yen.
Land tax	66·5
Income tax	24·5
Miscellaneous (licences, mining, bonuses, and patent medicines)	17·2
2. Special tax on land	9·1
3. House tax	37·8
4. Licence fees	7·3
5. Miscellaneous	49·6
Total	212

¹ SOURCE.—*Financial and Economic Annual of Japan*, 1934 (Japan, Dept. of Finance).

Local Taxes, 1933

1. Supplements to National taxes—	Million Yen
Land tax	38.3
Income tax	8.9
Miscellaneous (licences, mining, bonuses, and patent medicines)	23
2. Additional taxes to Prefectural taxes—	
Special tax on land	4.9
House tax	53.8
Licence fees	6.6
Miscellaneous	47.8
3. Special taxes levied by cities, towns, and villages . . .	121.5
Total	304.8
GRAND TOTAL	<u>516.8</u>

This method is followed, as we have seen, in the case of the income of District Boards in India. It is capable of expansion in some countries owing to the fact that this method of collection is economical and, on the whole, convenient. The proceeds are frequently collected by the National or State Governments and distributed to the local authorities according to a fixed standard. In Germany, for example, the National Government collects certain taxes, retaining a small percentage for the cost of collection. Out of 203.5 million marks, the proceeds of the tax on motor vehicles for the year 1930–31, the National Government retained only 8400 marks. The licence tax in France is a fixed and proportional tax. The fixed tax is the tax on the tax on each profession, and it is determined by a schedule of rates that takes account of different indices such as the nature of the profession, the size of the commune in which the profession is practised, the number of workers, machines, etc. The proportional tax is fixed on the basis of the rental value of the dwelling and building or buildings in which the business is located. Individuals or companies conducting a business, an industry, or a profession in France not included in the exemptions established by law are liable for the tax. It is imposed in the communes in which the establishments or taxable premises are located and varies according to communes. It is shared among the department, the commune, and also the Bourses and Chambers of Commerce. In Prussia the business tax is levied on every business enterprise as we have seen, and is based on the profits or capital or wages. For the

profits tax and the capital tax payment is made quarterly, and on the total wages paid monthly. The rate for the communes is expressed as a percentage on the State tax, 500, 1000, or 1600 per cent as the case may be, the assessment rates varying very considerably in Prussia. Besides the business tax there are the tax on peddling, which is paid annually before beginning business, and also the tax on itinerant store or stock of goods. In the latter of these two State taxes the communes increase these rates by an additional amount.

There is a great contrast between local taxation in this respect, between Great Britain and France, just as there is a great difference between the south and east of India and the north and west of India. In France and the north-west of India local authorities prefer indirect taxation to direct taxation, while in Great Britain and south and east India local authorities prefer direct taxation, the direct taxation being mainly a tax on professions and trades, as well as on property. In some states of the United States professions taxes in the form of licences are levied, for example, in New York State on real estate brokers and real estate salesmen, on operators and on chauffeurs. The licences on the last two classes alone brought in \$2.9 millions in 1932.

It will be noticed in the table on local taxation for France that octroi duties were the second most important source of revenue, and it has been customary to levy such taxes in other countries, especially on the continent of Europe and in some parts of India, quite apart from other indirect taxes. It is difficult for English and American writers to appreciate the advantages of such a form of taxation which is regarded as a primitive form of taxation offending against most of the canons of taxation. The establishment or amendment of the octrois schedules require a greater knowledge of economic factors than is generally possessed by municipal boards, and there is the danger inherent in such schedules that they may be made in the interest of particular sections than in the interest of the communities at large. They are, too, a restraint on trade. They are very ancient, as, for example, they were levied on wines and certain articles of food imported into or exported from Roman towns. In recent years there has been a decided tendency to restrict the collection of such duties in favour of a tax on land and houses, a professional tax, the taxation of markets, and a sales tax. In Belgium the

octroi was given up because of its being a hindrance to trade. The agitation for the abolition of octrois began in 1839, and resulted in the legislation of 1860, when it was no longer necessary to chronicle the intestine war of tariffs. "Six declarations, six formalities, six transit dues", said M. Richald before their abolition, "must be paid to transport a bottle of wine from Brussels to Liège."¹ Up to 1923 the National Government in Italy received a share in the octroi duties, but by decree of 1923 the communes were given the sole right to levy such duties in lieu of Government subsidies, and by the Italian tax code which came into force in 1932 all octrois were abolished, as has been noted in Chapter XXVII. The worst features of the octrois are the *ad valorem* assessment and the delay in delivery resulting in damage to goods combined with the difficulty of getting refunds. In France the duties on account of their inconvenience, high cost of collection, and heavy incidence on the poorer classes have been unpopular. Frequent suggestions have been made for their abolition, but owing to the difficulty of finding out necessary substitutes this has not been possible. A policy of gradual suppression of octrois is in operation. The French system, however, provides for prompt refunds in the case of re-exported articles. The duties being an impediment to trade and industries also raise the price of articles of common use, and for this reason have been abolished in Holland, Denmark, Norway, Sweden, and other countries. The main argument for their retention is perhaps that they are an important source of local revenue and their incidence is shifted little by little on to the consumer. If it is not possible to substitute such taxes as a tax on property, a tax on professions, and a tax from letting stalls in municipal markets coupled with the taxes of private markets and a sales tax on total turnover (on wholesale or retail transactions or on both), limitations should be imposed on the use of octroi taxes as far as possible. A terminal tax, which is an octroi without refunds, would be productive although inconvenient to collect. If therefore taxes are to be levied, either octroi or terminal taxes, the rates should be low, and to prevent the tax from becoming a transit duty refunds should be promptly given on exported goods. Areas should be made also for bonding goods intended for through

¹ Louis Richald, *Les Finances communales en Belgique*, vol. i. p. 135 (Bruxelles, 1892, 4 vols.).

transit. Care should be taken to see that the staff is well paid and efficiently controlled, and no interference should be possible in the way of local pressure on officials. Tolls are sometimes levied and may be justified when they form a part of a scheme for the taxation of vehicles, and as far as possible they should be abolished in favour of the taxation of vehicles. Tolls are frequently levied by cities to counterbalance the terminal tax on goods arriving by rail, but the objection to tolls which supplement consumption taxes is that they are an impediment to traffic and trade. These taxes on trade are often an obstruction to inter-State or inter-provincial traffic.

In a previous chapter a reference has been made to the taxation of site values.¹ For local purposes a special tax on the value of land apart from any structure on it has proved to be a useful subsidiary source of revenue. Site values have increased and are increasing rapidly in large cities, and also in towns. Owners of land gain more from local expenditure than other taxpayers. Why, therefore, should the tax not be generally imposed? It will not check improvements. Site value being a differential rent, a tax on it cannot be shifted. A tax on differential rent does not interfere with the supply of land. It does not, in short, affect production. The popularity of this tax in many countries as a source of revenue has increased in recent years, especially in Australia and in Canada. As a rule in Australia it is customary to use this as a source of State revenue rather than of local. In Prussia, there is a tax on the improved real estate not used for agricultural purposes under the house tax. It is based on 300-920 per cent of the land tax. The tax is levied both by the State and communes. Similarly in Italy there is a tax on unearned increment on real estate levied by the communes. It is based on the difference between the market price following improvements and that preceding improvements. The rate of tax is not to exceed 15 per cent of the increments, or the total paid by proprietors must not exceed 30 per cent of public expenditure. The tax for the unimproved values of land is an excellent tax for local purposes in cases where cities are spreading rapidly and the value of the land increasing by leaps and bounds without any effort, intelligence, or risk on the part of the owner.

In several countries an income tax has been imposed as a

¹ Chapter XIX.

source of local revenue. In the United States, for example, Massachusetts, Mississippi, Missouri, New Hampshire, Georgia, North and South Carolina, North Dakota, Oklahoma, Vermont, Virginia, and Wisconsin have a local income tax on individuals or corporations or on both, in addition to the Federal income tax. Expert authorities have suggested an income tax of this nature as more satisfactory than the general property tax. It is more used by the states than by purely local authorities. In Wisconsin, however, to take one example, there is a graduated income tax on the incomes of individuals and corporations from 1 to 7 per cent : 40 per cent is retained by the State and 10 per cent goes to counties, while 50 per cent goes to the cities, villages, and towns. In Prussia, in addition to the German national income tax, there is a personal tax on the amount of annual income, the tax varying with the size of income. It is assessed locally. In the cantons of Switzerland a tax on income for use by local authorities is not unknown, as, for example, in the canton of Baselstadt. By the law of 6th April 1922 there is an income tax varying from 5 to 12½ per cent in the municipality of Basel, and a tax in two other communities varying from 0·25 to 6·25 per cent. Communities, except the municipality of Basel, are authorised to collect a local tax. In Berne by the legislation of 1920 and 1926 there is a State income tax of 4·65 per cent, and a local tax is levied on the basis of the State tax and it varies according to local requirements. In Zurich there is a graduated income tax under the laws of 1922 and 1928 which is graduated from 1 to 6 per cent, and local communities may raise up to 250 per cent of the State tax for local purposes. Similarly in the canton of Geneva income tax is levied from 1 to 8 per cent. There is a 10 per cent surtax for single persons with incomes of over Frs.10,000. Local communities are authorised to collect an additional tax on the basis of the State tax. In Finland the income tax was by far the most important source of local taxation in 1933. The rural and municipal income tax produced nine-tenths of the local taxation. In Denmark this tax (*the Personalige Skatter*) was two-thirds of local taxation, and in Sweden the tax is also of some importance. In municipal taxation the local income tax is sometimes one of the chief sources of revenue, as in Finland, Norway, and Sweden. In Holland, as has been seen,¹ the Government

¹ Cf. Chapter XVI, para. 2.

prohibited local income taxation in 1929 for local purposes, and in its place created a communal fund from which grants are made to local authorities. The difficulties of a local income tax are the impossibilities of accurately localising income and the danger of evasion by migration on the part of the taxpayer to areas where a lower rate of local income tax obtains or where there is no tax at all. We are sometimes apt to underestimate the value of high local taxation in preventing people from bunching together in crowded areas. High taxes spread them in the suburbs of large towns. In a British Official Report it is stated of the Prussian income tax that "The system prevailing in Prussia is thorough and just", and that the poorer classes were relieved of this tax. It also referred to the honesty prevailing in the self-assessments of those enjoying an income over a prescribed limit which was "a surprise even to the optimists". Here again local conditions play a considerable part in the determination of whether a local income tax is to be preferred to, for example, the system of rating as in Great Britain. Rating is held to be a more equitable mode of assessing local benefit than a local income tax. A local income tax, on the other hand, is of far greater productiveness and convenience than octrois. Nevertheless, a local income tax has certain disadvantages, such as the fact that incomes are frequently derived from sources outside the locality and consequently are not effected by local improvements. It is also a difficult basis of assessing the great body of wage-earners who are benefited by local expenditures. It is also difficult to apply in the cases of banks and businesses which are merely represented by branches in the locality. These, however, could, as in New York and other states of the American Union, be separately taxed. A local income tax would never be possible in England, because rating is thought to work well on the whole and to have less difficulties than those of a local income tax.

Miscellaneous taxes for local purposes include a large miscellany such as is to be found in the Commonwealths of the American Union where direct and indirect taxes are levied by local authorities. There are, for example, direct taxes levied on banks and other corporations either on net income or on the privilege of being permitted to do business within the areas. There are amusement taxes, gasolene taxes, taxes on horse-racing, on beverages, alcoholic and non-alcoholic, tobacco, electricity,

motor vehicles, and taxes on sales. On the Continent there are a large number of taxes apart from the taxes on land and buildings. In addition to those already mentioned, there are one or two others of importance, such as the taxes on domestic servants and meat taxes. Thus in the communes of Italy there are to be found taxes on domestic servants, animals, meat, and public notices. In France there are many taxes such as those on animals, dog taxes, and collection of taxes established by the Law of 13th August 1926. In Germany, apart from the taxes discussed above there are, as in Bavaria, indirect taxes such as meat taxes on the slaughtering of animals, on the importation of meat, and on wild game that has been brought down at the chase. In Prussia are to be found such taxes as the amusement tax, the local beer and liquor tax, the dog tax, a tax on hunting, and liquor permits. To give an analysis of these taxes in various countries would bewilder and terrify the reader.

Lastly, some forms of direct taxation are unsuitable as sources of local revenue. Of these the inheritance tax, the taxation of companies or corporations, and the taxation of income are perhaps the best examples. It is preferable for national governments to collect the income tax and to share it with local authorities if necessary, or to permit these authorities to levy *centimes additionnels*. Certain forms of indirect taxation, as has been noted above, are also undesirable, such as excise duties, since these are liable to evasion and may interfere with federal or state taxation of the same character, as well as being liable to give rise to corruption. A local sales tax is also undesirable. A limit of profit to be permitted to municipal public utilities is often required in order to prevent these from making unreasonably high profits, which are then in the form of indirect taxation. The present attitude towards the taxation of a long list of subjects such as we find in certain Swiss cantons and Czechoslovakia has already been referred to in dealing with octrois.

3. SOME PRINCIPLES OF LOCAL TAXATION

Local taxation varies considerably from locality to locality. This inequality results from several factors. A local authority may perform greater services than a local authority in another area. The same service may cost more in certain districts than

in others owing to topographical disadvantages. Some local authorities may have endowments or voluntary or special contributions to meet expenditure on certain public undertakings, and thus may be in a position to levy less rates or local taxes. In some places the extent and therefore the expenditure on national or quasi-national services may be greater than in others, as, for example, in regard to public assistance. Some districts may receive a greater yield from capital invested in the past, while others find themselves compelled to undertake public works which may be paid out from revenue or capital or from both. Lastly, the variation in tax rates may be due to the relative efficiency of local authorities. The notorious extravagance of some authorities resulted in high rates in those areas. The word "Poplarism" in Great Britain was coined to denote extravagance and inefficiency of this sort.

The principle of local taxation has sometimes been distinguished from the principle of national taxation on account of the greater importance attached in local taxation to the benefit basis of the impositions. It is sometimes said that it is easier to trace the advantage accruing to owners of property in a given locality than it is to trace the benefit conferred by national taxation. Therefore, it has been said, real property is on the whole a fair measurement of the benefit derived from local administration. This, however, is not quite correct, because much of the expenditure of local authorities to-day is of a national or quasi-national nature. In the Scottish distressed areas the British Exchequer is bearing 95 per cent of the cost of relieving the able-bodied who come within the scope of Part II. of the Unemployment Act, 1934, and only 5 per cent, therefore, of the expenditure on able-bodied poor is met by the local authority. Grants-in-aid similarly relieve local expenditure to a large extent. Thus in 1930-31 Government grants in England and Wales amounted to over £130 millions, excluding £7 millions in respect of capital works. Public rates in the same year were £149 millions. The total expenditure other than from loans on capital works was £432.7 millions. These figures show the importance of Government grants in aid of the cost of specified and non-specified services under the Local Government Act, 1929.¹

Property is not always in local taxation a fair index of the

¹ Statistical Abstract for U.K., Cmd. 4489, 1934, pp. 191, 196, and 199.

occupier's ability to pay. A man with a large family and a relatively small income may have to live in a large house. He may also have to live in an expensive area in order to conduct his profession or business. Doctors or dentists are cases in point. The value of a house, therefore, is not necessarily an indication of the occupier's ability to pay. Another objection to the rating principle is that it is particularly heavy in poorer districts, and it thus imposes a relatively greater burden on investors in capital and property in these districts. In this regard, however, so far as the burden on landlords goes, the tendency is that if the rates are of long standing these will become capitalised. The old rule "an old tax is a good tax" or no tax clearly applies to old rates. The inequalities mentioned, too, are in some degree removed by the system of grants-in-aid in the British system. Another objection to the principle of rating is that already recognised by the Local Government Act, 1929. If local rates are high, many manufacturers will tend to shift their places of business to less heavily rated districts. By the Local Government Act of 1929 industry was relieved of part of the burden of local rates by the de-rating of certain properties, and contributions on a fair basis were given to the upkeep of roads and public assistance or poor relief. Agricultural buildings and land are now entirely exempt from local rates; industrial and mining properties are rated at one-fourth of their assessable value; and railways were similarly rated at one-fourth, but the money saved is devoted to the reduction of freight charges on certain classes of goods. The comparative advantages of rates, octrois, and a personal income tax have already been dealt with above.

4. THE EXECUTIVE IN LOCAL FINANCE

Another feature that emerges from a survey of local taxing authorities is the necessity at the present time of separating purely executive functions from municipal and similar councils. This is imperative in view of the growing importance of local finance, and it is essential to concentrate authority as far as practicable and to define, if not to restrict, the powers of local authorities. Thus in the United States the fundamental principle of reform in city governments has been the attempt to fix responsibility by extending the power of the mayor, and while giving

occupier's ability to pay. A man with a large family and a relatively small income may have to live in a large house. He may also have to live in an expensive area in order to conduct his profession or business. Doctors or dentists are cases in point. The value of a house, therefore, is not necessarily an indication of the occupier's ability to pay. Another objection to the rating principle is that it is particularly heavy in poorer districts, and it thus imposes a relatively greater burden on investors in capital and property in these districts. In this regard, however, so far as the burden on landlords goes, the tendency is that if the rates are of long standing these will become capitalised. The old rule "an old tax is a good tax" or no tax clearly applies to old rates. The inequalities mentioned, too, are in some degree removed by the system of grants-in-aid in the British system. Another objection to the principle of rating is that already recognised by the Local Government Act, 1929. If local rates are high, many manufacturers will tend to shift their places of business to less heavily rated districts. By the Local Government Act of 1929 industry was relieved of part of the burden of local rates by the de-rating of certain properties, and contributions on a fair basis were given to the upkeep of roads and public assistance or poor relief. Agricultural buildings and land are now entirely exempt from local rates; industrial and mining properties are rated at one-fourth of their assessable value; and railways were similarly rated at one-fourth, but the money saved is devoted to the reduction of freight charges on certain classes of goods. The comparative advantages of rates, octrois, and a personal income tax have already been dealt with above.

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him the power of an executive¹ it takes from the councils, as far as possible, their executive functions. In Germany this is best illustrated by looking at the Berlin municipal constitution,² where the city administration is in the hands of an executive board, which is the executive for purely city affairs and also the State's representative for State functions. In the former it is responsible to the municipal council, and in the latter to the State Government. This executive (the *Magistrat*) is not bound to carry out the will of the city council, and it has the right, and, if the council wishes, may be required, to send representatives to the meetings of the council. When the mayor (who has the right of veto over the board's decisions) is in conflict with the board the ultimate decision rests with the Supreme Administrative Court. In cases where differences arise between the executive board and the municipal council the Supreme Administrative Court is the first and final authority. In the cases of other municipalities the general rule is to appeal to the district committee as an administrative court, and finally to the Supreme Administrative Court. All members of the executive board, salaried and unsalaried, are elected by the city council. The municipal council's powers are not defined in the Act, but are limited in so far as powers are vested in the executive board and by the general sphere of municipal action through standing committees—the deputations—made up of city councillors and private citizens elected by the city council, and to which the executive board adds a number of its members. As one authority expresses it, “We have here one of the peculiar characteristics of the Berlin administrative system. It is an attempt to bring about a personal union between the executive and legislative branches of the city government and the general body of citizens.”

The constitution of some commonwealths³ in the United States forbids the State legislature (1) to allow any local body to lend its credit to other local bodies, counties, cities, boroughs,

¹ E.g. the Act for “the Government of Cities of the First Class” in Pennsylvania, known as the Bullett Act, 1885.

² Cf. Von Kaufmann's *Die Kommunalfinanzen* (2 vols., Leipsic, 1906); Dawson's informing *Municipal Life and Government in Germany*; Shaw's *Municipal Government in Continental Europe*, especially Appendix II. “The Budget of Berlin”.

³ E.g. the Constitution of Pennsylvania.

townships, or other incorporated district ; and (2) to assume the indebtedness of any local body except in the case of insurrection or invasion. No local body is permitted to increase its indebtedness beyond a certain statutory percentage of the assessed property valuation without the consent of the electors at a public election,¹ or to contract a debt except by providing for the collection of a tax to meet interest payments and the repayment of the principal within thirty years.² This has been done to check waste. It is a policy that has not been altogether successful. The fixing of a maximum tax rate has sometimes been an incentive to borrowing and to make future generations pay. In France³ the raising of extraordinary taxes or the contracting of loans as well as the approval of the local Budget requires higher sanction—in the case of communes by the Prefect, or in the cases of larger communes by the President of the Republic. In Italy as in Belgium the control over resolutions of the municipal council belongs to the permanent delegations or deputations of the provincial council. This has a stimulating effect on local taxation.

A strong executive in regard to taxation and financial advice is now essential. Some one of authority, not a mere accountant, but one well versed in pure finance, the loan market, and general principles of expenditure and taxation, is necessary to say “No”, an authority which will be regarded pretty much as H.M. Treasury among Government departments in Great Britain. A careful scrutiny of the Budgets before approval and before the year commences, an examination of the appropriations or accounts after the close of the year, and a scrutiny of proposed loans⁴ should be general. An efficiency audit is required, as this looks at results obtained and discovers when they are an unsatisfactory return for the money which has been spent. A detailed survey or inquiry into taxation with a view to economy is advantageous and should be undertaken once in every quinquennium by

¹ Limited to 2 per cent above the statutory 7 per cent. This can be avoided by increasing the valuation of the taxable property.

² Constitution of Pennsylvania.

³ Cf. The French Municipal Code (Shaw, *Municipal Government in Continental Europe*, Appendix III.).

⁴ Cf. English Local Loans Act, 1875. Unfortunately in Great Britain private legislation in regard to this has not been beneficial in the long run. Parliament has been much too lax; cf. the absence of this in France and Germany. In France and Germany recourse is not had to a central department but to a higher local authority; cf. London County Council, which can sanction loans proposed by the London Borough Councils.

an impartial authority. Otherwise there may be waste of local funds and high taxation owing to unnecessary expenditure and local indebtedness mounting up more quickly than income from rateable property.¹ Profits, too, which are made from municipal trading should be regarded from a commercial accounting point of view, due allowances being made for depreciation, sinking funds, etc. Occasional and amateurish inquiries have not the bracing effect on local taxation which expert inquiries have, as the latter give full and authentic information upon the merits of expenditure as well as its legal propriety. One's finger can thus be put on unnecessary expenditure and taxation. The existence of such a curb on municipal enthusiasm is advantageous. It prevents illegal expenditure, and compels adequate expenditure on education and all other matters of public administration. Above all, it keeps local taxation within reasonable limits.²

Lastly, there is the question of jurisdiction in local taxation. In Great Britain in recent years there has been a federation of smaller units into a large unit to deal with common interests, and this has increased considerably the efficiency of the executive both in England and Wales and in Scotland. For example, education in charge of County Councils has led to the administration of small areas into one large area, all the chief officers of which are available for consultation and advice in regard to educational buildings, health of children, and various other matters connected with education. Not only is this the case with executive officers but also with regard to non-officials in the elected Council, who have perhaps a wider outlook and more experience in the various walks of life than had the members of the old school boards. At the same time the areas should not be too large. In Europe there has been a growth upwards to larger areas. The reverse of what is taking place in Europe is to be found in India. There are 682 local boards or one to 1494 square miles, while in France approximately 37,962 communes or one to

¹ "The Growth of Municipal and National Expenditure and Local and Imperial Burdens", Lord Avebury, *Journal of Royal Statistical Society*, vol. lxiv., 1901.

² Cf. Percy Ashley, "The Financial Control of Local Authorities", p. 182, *Economic Journal*, vol. xii., 1902. Cf English Local Government Act, 1894, and the "adoptive Acts" for the establishment of libraries where local authorities in Prussia cannot increase the addition to the State income tax by 100 per cent without sanction.

only 6 square miles. The large jurisdiction of local bodies gives rise to great difficulties in local administration, especially in regard to taxation, since the ease in raising contributions for local purposes increases, other things being equal, with the decrease in the unit of taxation.

BOOK IV

PUBLIC DEBT

CHAPTER XXXII

THE GENERAL CHARACTERISTICS OF PUBLIC DEBTS

1. THE CLASSIFICATION OF PUBLIC DEBTS

WE now turn from the problem of finance by taxation to the problem of finance by borrowing. It is necessary here to resume the threads of discussion on the theory of public debt or public credit which was discussed in Chapter XI of Book II and to analyse in somewhat greater detail several of the unsettled questions of public credit.

In financial literature the term ‘public debt’ has not always the same meaning, and care must be taken in using the term to see what it actually means in the circumstances of each case. In the official returns of countries the term varies in meaning so that comparison of the financial debts of countries is not always possible. Some countries, for example Great Britain, include war and relief debts between one state and another in the public debt; others, as for example Italy, exclude war debts from the official returns. Reparations, except in the case of Bulgaria, are ordinarily excluded. In other directions comparisons are vitiated because the gross amount of debt is given in some cases, while in other cases the net amount of debt, after deducting sinking funds and securities withdrawn but not yet cancelled, is shown. Debts to Central Banks are not always given in the official statements. There is no uniform practice of showing annuities, since some countries show the total sum of the annuities to be paid while others show the present value calculated at varying rates of interest. The exact distinction between internal or domestic debt and external or foreign debt is not uniform in all countries. Some countries use the term foreign debt to mean debt floated in countries abroad. Other countries would include all debt which is held by bondholders abroad; in other words, the

country of residence is the determining factor. In some cases debts due to domestic banks which have raised funds abroad are classified as foreign debt.

The distinction between funded and floating debt is not always the same in all countries. Funded debt is frequently defined as debt the repayment of which will be made by the State at some distant date after due notice according to the terms of the prospectus issued at the time of the loan. Funded debt is frequently used in the sense of permanent debt—all debt raised by Government in the open market which, at the time when it is raised, has a currency of more than one year. Another definition—the definition used in the British Accounts—is that debt which has no fixed date for repayment, the stockholder having no claim to the repayment of the principal. The State may, however, repay the loan *after* a fixed date subject to notice. Thus it includes Consols, certain debts to the Banks of England and Ireland, the 4 per cent Consolidated Loan, the $3\frac{1}{2}$ per cent Conversion Loan, and the $3\frac{1}{2}$ per cent War Loan. Thus 'Goschens' were guaranteed only against redemption before 1923. The $3\frac{1}{2}$ per cent Conversion Loan is redeemable only at the option of the Government after 1961 and not at any fixed date. No debt is perpetual in the sense that it can never be repaid since the Government reserves an option to repay on or after a fixed due date upon the terms laid down at the time of the issue of the loan. Prior to the War almost the whole of the debt was in this form, but since 1914 there have been only the $3\frac{1}{2}$ per cent Conversion Loan, the 4 per cent Consolidated Loan, and the $3\frac{1}{2}$ per cent War Loan. Consols owe their origin to the passing of an Act of Parliament in 1751, when five different loans and certain annuities were consolidated into one stock bearing 3 per cent interest. The fund in the eighteenth century consisted of receipts from taxes appropriated to the discharge of both interest and the principal of the loan. Gradually the term 'fund' changed from the security upon which loans were advanced to the principal of the loans themselves. Sometimes several loans and pledged funds were consolidated. Hence the expression public or consolidated funds or consols, first used in 1751. Hence too the expression 'funding system' in English finance, which means the system or problems connected with the floating of permanent debt, including the issue of loans at par or at a discount and the

conversion of floating debt into permanent or funded debt. Unfunded debt is all debt other than the funded or permanent portion of the public debt.

The unfunded debt in British financial parlance consists of those loans which are redeemable *at a definite date* with or without an option to repay at an earlier date. It includes in this sense floating debt, *i.e.* Treasury Bills¹ and Ways and Means advances. The advantage to Government of the perpetual form is that Government can redeem or amortise the loan at its convenience. But in the case of perpetual loans it is very unusual to repay the loan. Speculators as a rule prefer perpetual loans as the fluctuation in the prices of such loans are very considerable. Perpetual loans do not really yield a constant rate of interest, because if the rate is above that of the market rate, the State will convert the loan into a loan carrying a lower rate of interest. On the other hand, if the rate is below the market rate the sale value of the stock will fall. Trustees and other investors prefer long-term loans as it appears to give them a definite return on their capital over long periods. In some countries it is customary for long-dated government stocks to be trustee securities, which means that trustees are authorised to invest trust funds in these securities. In Great Britain under the Trustee Act of 1925 consols, war loans and other British Government securities, Bank of England stock, certain overseas Government stocks, certain debenture or preference railway stocks of Great Britain and India and certain British municipal stocks are of this nature.

Floating debt is debt which is payable within a year. The League of Nations, however, regards floating debt as debt falling due within a period of less than two years from the date from which the debt was contracted. In Great Britain it is limited to Treasury Bills and to Ways and Means advances by the Bank of England to the Government. The dividing line between short-term and even long-term loans or public debts nearing the date of maturity is not always rigid, as short-term and even long-term loans approaching this date have the character of floating debts.

¹ Treasury Bills took the place of Exchequer Bills when the latter were discontinued in 1877. Exchequer Bills were first issued in 1696 and are not to be confused with Exchequer Bonds which were introduced in 1853 by Mr. Gladstone. The original Exchequer Bills of 1696 were payable at any time on demand like bank notes.

Sometimes the expression short-term debt applies to debt intermediate between floating debt and long-term debt. In France the categories are permanent and long-term debt, short-term debt, and floating debt. Short-term debt is debt over a year and not more than ten years. In the United States the expression Treasury Certificates of indebtedness is applied to maturities not exceeding one year, while Treasury Notes apply to maturities from one to five years. Maturities exceeding five years are called Bonds. The expression deadweight debt means all public debts against which there are no particular assets. It, therefore, in British financial parlance includes all funded and unfunded debt and annuities but excludes 'other capital liabilities', which are debts for productive purposes or for certain capital works of a durable nature. The interest on the latter is met from votes of Parliament, instead of, in the case of deadweight debt, from the Consolidated Fund. Terminable annuities are not always shown in the same manner. There is no uniform practice of showing annuities, since some countries show the total sum to be paid, while others show the present calculated at varying rates of interest. Terminable annuities are relatively unimportant. In the case of Great Britain they consist almost entirely of the liability of the National Debt Commissioners to the public in respect of annuities sold for life and for a term of years. The issue of these annuities is in return for cash or Government stock, the cash is applied to the purchase and cancellation of Government stock, the instalment of the annuities being charged on the Consolidated Fund. Annuities in Great Britain are now limited to life. A deferred or reversionary annuity is one that does not commence until after a certain period of years or after the decease of a person. An annuity in possession is one that has already commenced. Tontines,¹ named after the inventor Tonti, an Italian banker of the seventeenth century, are annuities shared by subscribers to a loan with the benefit of survivorship, the annuities being increased as the subscribers die, until at last the whole goes to the last survivor or to the last two or three according to the terms of the tontine. A Mr. Martin who was nominated

¹ For Tontines in the United Kingdom see the invaluable *Return of Public Income and Expenditure* (No. 366, i. 1869), App. 13, p. 571. This return, in two volumes, is usually known as "Chisholm", who was the chief clerk of the Treasury mainly responsible for the work.

a subscriber to a tontine and died in his 92nd year, in return for £100 originally contracted, received as dividend for the preceding six months in January 1870, £3875 : 0 : 4, and in July 1870, £3891 : 10 : 2. The amount originally borrowed by the British Government was £228,000 at 7 per cent. The principal of each subscriber (£100) lapsed at death, while the entire interest was divided among the survivors.

Public debts may be classified according to the particular viewpoint under consideration. They may be classified according to (1) the period or duration of the loan—permanent or irredeemable debt in contrast to redeemable debt, long-term in contrast to short-term debt; (2) the method of flotation—voluntary or compulsory loans; (3) the place of flotation—internal as opposed to external debt; and (4) the purpose for which the debts are contracted, such as productive or unproductive or dead-weight debt.

It is possible to classify states into (1) those which borrow at low interest, the well financed states; (2) states at moderate interest, *i.e.* those states which borrow freely but not beyond their resources; (3) states of high interest whose debts are heavy and increase more rapidly than their resources; and (4) states of excessive interest. Those of the last class are the defaulting or insolvent states. Dudley Baxter¹ classified the countries into groups such as these. In group (1) he included the states which paid, in 1874, 3 and 4 per cent interest, such states as the United Kingdom, the Netherlands, Belgium, Germany, India, Canada, Sweden, Australia, and New Zealand; states of moderate interest (5 to 6½ per cent) included the United States, France, Russia, Chile and the Argentine, and the states paying high interest (6½ to 10 per cent) were Japan, Austria, Hungary, Columbia, Italy, Egypt and Turkey. States paying excessive interest (above 10 per cent) included Spain and Greece and a collection of Spanish-American colonies near the Equator. In 1874 Paraguay and Venezuela were paying on the market price of the loans 25 per cent, Greece 30 per cent, and Honduras no less than 66 per cent. This last class is a good example of Wellington's maxim that high interest means bad security, or rather the converse, bad security requires high interest. Lord Rothschild, before the Select Com-

¹ "The Recent Progress of National Debts", *Journal of the Royal Statistical Society*, vol. xxxvii., 1874.

mittee of the House of Commons on Foreign Loans, touched the core of the problem when he said "The disease is the desire of people to get a high rate of interest for their money". Unfortunately a proper insight into the facts of each investment is not always made, so that the causes justifying the higher rate of interest are sometimes overlooked. When a country has much floating capital, especially when it is in the hands of a few large owners, the tendency is to be satisfied with a moderate rate of interest provided this is accompanied by security. The larger a man's wealth the more careful is he in the distribution of his capital, and as a rule he invests it in Government funds bearing a comparatively low but safe rate of interest. This enables him to be free from care and worry and to enjoy the other interests of life which the man of smaller fortune, eager to earn the most from his capital, cannot always follow. Men, it is said, do not become rich by investing in Government bonds ; they invest in Government loans because they are rich. It is not always the opinions current among a people or even among the investing class which settles the question of the rate of interest of another foreign country. Political and other influences have a great deal to do with this. The widespread practice of saving and investing in rentes by the rank and file of small capitalists in France and their thriftiness as well as their patriotic instincts account for the comparatively high prices which rentes maintain. The State which consistently meets its promises is in the front rank of borrowers, while those whose pledged word cannot be relied on stand at the further extreme. In an analysis of public debts (and public debts are as indispensable to-day as they were a hundred years ago) we see the importance of good feeling and confidence and the bad effects of one country making ugly faces at another. This prevents the free movement of capital between countries to a degree that is scarcely ever realised.

The fundamental characteristic of a public debt is that it is contracted between the State as a borrower and the private owner of capital as creditor. Such debts are sometimes spoken of as commercial debts. The State enters into a contract to pay the interest and to repay the capital. The service of the debt becomes a first charge on revenue. The State cannot, by unilateral action by itself, modify the rate of interest or the conditions

of amortisation, nor can it inflate the currency to reduce the burden of its indebtedness unless it wishes to become bankrupt, and to receive a blow the recovery from which may take years, if indeed it can recover at all. Any financial operation under this definition which lacks the characteristic of voluntary borrowing on the part of the parties to the contract would not be regarded as a public debt. Forced loans and issues of Government currency notes are not in this view public debt. A forced or compulsory loan has many of the characteristics of a tax. The terms may have no reference to the credit market, these loans being resorted to only when the Governments are unable to borrow in the market in this usual way on normal terms. Forced loans can only be raised within the jurisdiction of the borrowing State and consequently they are limited in the operation. The use of Government currency and promissory notes, when these notes are made legal tender and forced into circulation, is in effect borrowing by compulsion. The issue of inconvertible currency is nothing more than the equivalent of a forced loan on the metallic money circulation in a country. It is a means of increasing very rapidly monetary circulation. There is the possibility of over-issue resulting in inflation and in the deterioration of the financial and economic health of the country concerned. The issue of inconvertible paper frequently inflicts incalculable loss on the community by the resulting inflation of prices with its violent effects on those with fixed incomes and the poorer classes from whom a relatively greater contribution is exacted, as they are affected by the change in prices, especially of food, more than the rich, and their wages do not move in harmony with prices. Foreign trade is upset by the depreciation of the foreign exchanges, and indeed the whole of public credit is severely damaged. The experience of both Germany in 1922–23 and France in 1926 before stabilisation, have shown the damaging effects of this method of raising loans. Debts in the nature of unpaid bills for public works, pensions to the Civil Service, and indemnities are not public debts.

In fiscal literature there is a difference of opinion with regard to war or inter-governmental debts. Some writers do not classify such debts as public debts because of the nature of these debts. “Financial commitments”, M. Gaston Jèze says, “of one state towards another such as war indemnities imposed by a victorious state upon the conquered or loans made by one state to another

in the pursuit of a common war or of any other common political goal, do not constitute a part of the public debt proper. These are political debts, and by reason of their origin and character are subject to a treatment different from that accorded to the debts owed to private lenders." These inter-governmental debts owe their origin usually in pursuit of a common war, and there was a direct or indirect advantage to the lending country, which could not afford to see its ally starved of ammunitions or collapsing owing to the lack of adequate financial assistance. There is no voluntary idea of contract between the State and the individual lender of capital. On the other hand, there is an act of public borrowing between State and State. Without taking up the extreme position of so able a thinker on fiscal problems as M. Jèze, we are of opinion that war debts may be regarded as public debts, but for the reasons just stated are different from public debts in the ordinary accepted sense. They do contain the idea of a contract, not it is true between State or individual borrower, but between Governments. They certainly require independent treatment on account of their origin, and also because in periods of depression following wars the interest payments on such debts upset international trade and consequently have their bad effects even on the lending country. They are part of the waste of war like the spent ammunitions for which they paid, and they encumber the return to normality, as the payments produce mal-adjustments which more than offset any benefit which they may bring, and as Mr. Mellon, a former Secretary of the American Treasury, said, "The entire foreign debt is not worth as much to the American people in dollars and cents as a prosperous Europe as a customer".

Sometimes loans are issued in the form of lottery loans, the lender being content with a small rate of interest or no rate of interest at all in return for the chance of winning a large prize by the systematic drawing of certain bonds. The lottery loan provides a cheaper method of flotation than would otherwise be possible, and this explains the reasons of its popularity in the financial history of many Governments. This form of loan for the benefit of the State was first floated in 1530, and the first record of a State lottery loan in England was in 1569. Lottery loans were introduced into Great Britain in 1569 and were a source of State revenue until 1826. This form of loan has been popular

in France, Belgium, Germany, Austria, and Italy, and is not used in Great Britain, the United States, and Japan, as it is held to be in the nature of gambling. Its permanence in the history of public loans is due to the fact that it provides a cheaper credit than is ordinarily obtainable if ordinary loans were floated. Purchasers may receive no interest at all but only the return of the face value of the lottery loan or the face value plus interest at a low rate. The former are sometimes called chance loans and the latter premium loans. The funds for the prizes are obtained in interest-bearing lottery loans from the difference between the low interest paid and the prevailing market rate, and in non-interest-bearing loans from the interest on the capital of the loan.

2. THE GROWTH OF PUBLIC DEBTS

Finance by borrowing has a position of great importance in public finance at the present time owing mainly to the fact that huge debts have been incurred in war and that the budgets of most countries are compelled to provide for large payments in the form of interest and sinking funds to ensure the repayment of capital. "It is only just over five years ago", said Mr. Lloyd George in the spring of 1924, "since the last guns ceased firing in a war of concentrated destruction such as the world has never seen. It cost the belligerent nations over £50,000,000,000; either by death or mutilation Europe was deprived of at least 25 millions of its best wealth-producers, and the whole of the delicate and complicated machinery of international trade was shattered." The public debt of twenty-seven countries in 1900 was £6,079,000,000; in 1913, the year before the War, £8,566,000,000; and in 1933 £22,000,000,000. In the space of three decades, therefore, the increase in debt has been three and a half times, an enormous increase. The net cost of the War has been estimated at nearly £42,000,000,000,¹ and expressed in 1913 pounds the net cost is over £16,000,000,000. The Seven Years' War, 1756-63, added £60,000,000 to the English National Debt, or practically doubled it. The American War, 1775-83, added £121,000,000 to this. The wars between 1793 and 1815 increased the public debt by no less than over £600,000,000, the English public debt in 1793

¹ Direct cost plus loans from Allies minus loans to Allies = net cost. To obtain the direct cost the normal estimated expenditures of pre-War years were

being £239,000,000. In Great Britain the ratio of public debt to ordinary revenue has increased from 3·6 times in the pre-War year to 10·6 at the present time ; in France from 6·9 to 9·8 ; from 1·6 to 9·8 in the United States ; from 5·1 to 5·7 in Italy ; in Japan from 4·5 to 6·3 ; in India 3·6 to 5·8, while in Germany the pre-War figure of 2 is the same as to-day. As we shall see in the following chapter, which deals with the burden of public debts, these figures are not of real value unless the nature of the debt is considered.

Local authorities as well as Governments have very noticeably widened the scope of their administrative functions, and this has led to a great increase in indebtedness on their part. Elsewhere we have noted the decentralisation that is taking place in expenditures, which is at the same time accompanied by a centralisation of revenues. As compared with the pre-War year British local indebtedness has greatly increased, and the expenditure on social services has increased more than six times as compared with pre-War years. In the United States in the post-War years local debts, mainly on account of education, roads, local administration and social welfare, have also greatly increased. Thus in 1928 the borrowing of local authorities amounted to \$11,106,000,000 as compared with the indebtedness of the states of only \$1,502,000,000. Local loans in the United States, by the restrictions of a constitutional and legislative nature on taxation and by the exemption of local bonds from taxation, have been

deducted from the total expenditures. The details of countries were (million dollars) :

	Net Cost.	Net Cost in 1913 Dollars	Central Powers.	Net Cost.	Net Cost in 1913 Dollars
British Empire .	49,764	23,048	Germany . .	47,048	19,894
France . .	28,160	9,282	Austria-Hungary	13,394	4,727
Belgium . .	..	..	Turkey . .	696	333
Italy . .	14,721	3,211	Bulgaria . .	322	- 274
United States .	36,186	17,139			
Total Allied and associated Powers (includ- ing the above States)	147,043	57,747	Total Central Powers	61,460	24,680

Therefore the total net cost (million dollars) is 208,503, and in 1913 dollars is (million dollars) 82,427. Cf. *The Inter-Ally Debts* (Bankers Trust Co., New York, 1924).

much encouraged. In almost all European countries the tendency to increased local indebtedness has been very marked. It has, however, been restricted, and fortunately this indebtedness is supervised and controlled by Governments, as Governments are affected by the competition of local authorities in the capital market.

3. PUBLIC CREDIT—A PRODUCT OF MODERN TIMES

Public loans in reality are a product of comparatively recent times. Until the Industrial Revolution hoarding was the normal form of saving. Throughout antiquity, the Middle Ages and for many centuries afterwards, it was the usual way of storing wealth for possible future use. Indeed the system of public credit was almost entirely non-existent up to the eighteenth century, except in a few small commercial republics, one or two trading states in Germany, and the Netherlands. Loans indeed were made from time to time on the personal credit of the monarch. The public did not subscribe as there was none of the developed system which is in universal operation to-day. As late as the eighteenth century business men have been known to have retired with chests of gold coins from the proceeds of which they lived on their savings. In the nineteenth century the growth of public credit was phenomenal and the development of the limited liability company had no small share in this. In the twentieth century the prodigious loans contracted for the War have further extended public credit and brought into relief its advantages, including the stimulation of thrift among the general public.

Hoarding differs from saving, as is generally understood, in that wealth does not find its way into investments, the hoarder receiving no yield from his wealth unless gold, silver, and other forms of durable goods appreciate in value. The hoarder is free from the risks of financial panic and depreciation but is exposed to the risk of theft. It is only in times of war or panic that he gains. In the ordinary times of peace all the advantages lie with the investor. Individual savings are not employed as productive capital by their owner largely because he has no alternative but to hoard them. Adam Smith in *The Wealth of Nations* states: "In a rude state of society there are no great mercantile or manufacturing capitals. The individuals, who hoard whatever

money they can save, and who conceal their hoard, do so from a distrust of the justice of Government, from a fear that if it was known that they had a hoard, and where that hoard was to be found, they would quickly be plundered.”¹ He points out, too, that a principal means of employing surplus wealth in England, during the Middle Ages and in many countries at the time when he wrote, was as in India to-day, by keeping large numbers of retainers who were, in his view, mainly unproductive consumers. Before the extension of commerce and manufactures in Europe, the hospitality of the rich and the great, from the sovereign down to the smallest baron, exceed everything which in the present times we can easily form a notion of.

Hoarding in the form of gold, silver, and precious stones is still a characteristic of India. It is sometimes not realised how great are the hoards in India to-day and even in the West. The population of India alone among the modern countries of the world continues to hoard precious stones, gold, and silver in large amounts because of immemorial custom which is of tremendous social significance. When it is remembered that Hinduism is professed by nearly two-thirds of a population of 353,000,000 and at the basis of its religious and social system is the phenomenon of caste, and that, too, except in a very restricted field it remains unaffected by contact with the philosophies of the West, the importance of the social system will be readily understood. It differs from the religion of Islam which has over 77,000,000 followers, as the latter is based upon the conception of the equality of man. There are a dozen main languages and over 200 minor dialects, and its people are often as distinct from one another in tradition and manner of life as are the nations of Europe. Hoarding, therefore, in conditions such as these flourishes. During the last hundred years India has imported £540,500,000 in gold which at present prices (1935) is about £900,000,000, and it has been tentatively estimated that the gold privately hoarded in India from 1493 to 1930 amounts at least to 15 per cent of the world’s production during the same period.² In China the habit of hoarding has never developed as in India, due perhaps to the greater stability of Chinese civilisation. There are in the West consider-

¹ *The Wealth of Nations*, Bk. V. ch. iii., Cannan edit. vol. ii. p. 396.

² From 1931 to the end of 1935, roughly one-sixth of the value of the gold hoarded was exported from India.

able hoards in precious stones, gold, silver, and works of art which amount in the mass to very large sums. All the famous diamonds of antiquity were Indian stones, such as the Koh-i-noor handed over to the British Crown by the East India Company in 1850, and the great Orloff diamond stolen by a French soldier from the eye of an idol in an Indian temple. Imports of gold and silver since the beginning of the century have been phenomenally large and run into many hundred millions sterling. In one of the largest Indian States the ruler's private treasure is considerably more than the equivalent of £10,000,000, and his jewels, when valued on his accession, amounted in value to £150,000,000. Throughout Indian history there have been large hoards, as for example in the time of Aurangzeb, who conducted his wars largely out of the hoards amassed by his predecessors. Vincent Smith mentions the hoards of Akbar in terms which are not an exaggeration : "The wealth of Akbar, the richest sovereign of his age, was far exceeded by the gigantic treasures of his grandson, who kept his principal hoard at Agra in two great underground-story rooms, one for gold and the other for silver—each seventy feet square and thirty feet high".¹ The enormous loot at Seringapatam, running into millions sterling, is a matter of history. We read, too, of the sack of Surat, not a large town, by Shivaji in his Mulukgiri raids in 1664 and again in 1670. Shivaji took away in the first sack of the town Rs.10,000,000 (at the then rate of exchange the equivalent of £1,000,000 sterling), and from the house of Baharaj Borah alone he took 28 lbs. of pearls, much jewellery, and an incredibly large amount of money. In the second sack the Mahratta conqueror took the equivalent of £660,000. In Madura to-day in a single temple there are hoards estimated at Rs.30,000,000 (£2,250,000), and in Ahmedabad religious hoards are Rs.10,000,000 (£750,000). The recent discovery of the Tut-Ankh-Amen treasures in Egypt, the hoards in Athens when Athenians amassed 10,000 talents in the interval between the first and second Peloponnesian Wars, the treasures which had been accumulated in temples such as that at Delphi plundered by the Phocians in 355 B.C., the 50,000 talents (the equivalent of £19,000,000) found by Alexander the Great at Susa, the 180,000 talents (the equivalent of £41,400,000), the accumulated treasure of Alexander at Ecbatana, are well-known historical facts. In

¹ Vincent A. Smith, *The Oxford History of India* (Oxford, 1919), pp. 392-93.

Rome the *fiscus* of the Emperors, especially preparatory to territorial expansion, had great reserves. There were also very rich men like Crassus, Maecenas, and also Herodes Atticus, whose splendid fortune, expended lavishly on public purposes, was founded upon a valuable hoard discovered in the reign of Nerva. As late as A.D. 637 the hoards at Ctesiphon near Baghdad, when captured by the Arab General Sa'ad, were so extensive and costly that, after one-fifth of the whole and works of art had been set apart for the Caliph, there were left 12,000 dirhems, the equivalent of £18,000,000, for distribution among his 60,000 soldiers. Germany and Russia hoarded gold before the War. No country, however, would think of keeping a large war hoard of gold as Germany did to the extent of £6,000,000, a part of the indemnity paid by France in 1871 by the Treaty of Frankfort, because a country even with moderate credit facilities can always raise loans without difficulty. Such a fund may give a country increased reliance for a short period before or at the beginning of a war, but in view of the development of public credit, such a method is considered to be out of harmony with present conditions.

To-day investment opportunities are widely developed and there is a growing sense even among small savers of security and confidence. Public credit has taken the place of State hoarding. It assumes developed industry, finance and commerce, internal and external peace, a well-ordered system of government, and a fiscal system in which taxation is the real source of revenue. The chief principle in a well-financed State in public, as in private finance, is that annual recurring expenditure must be met from annual revenue. The will and ability to pay taxes is the solid basis of public credit and taxation must be a normal source of public revenue. As Adam Smith with his usual accuracy of statement says, "a man must be crazy who, where there is tolerable security, does not employ all the stock which he commands". He reminds us that with the development of industry "commerce and manufactures can seldom flourish long in any State which does not enjoy a regular administration of justice in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the State is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in

short, can seldom flourish in any State in which there is not a certain degree of confidence in the justice of government. The same confidence which disposes great merchants and manufacturers, upon ordinary occasions, to trust their property to the protection of a particular Government disposes them, upon extraordinary occasions, to trust that Government with the use of their property. By lending money to Government, they do not even for a moment diminish their ability to carry on their trade and manufactures. On the contrary, they commonly augment it. The necessities of the State render Government upon most occasions willing to borrow upon terms extremely advantageous to the lender.”¹ The necessity of borrowing in a commercial state of society brings with it the facility of doing so. “A country abounding with merchants and manufacturers necessarily abounds with a set of people who have it at all times in their power to advance, if they choose to do so, a very large sum of money to Government. Hence the ability in the subjects of a commercial State to lend.”

4. THE ADVANTAGES AND DISADVANTAGES OF PUBLIC CREDIT

It is difficult to summarise briefly the advantages and disadvantages of public credit as many of these have been already referred to in previous paragraphs. Public credit enables capital to be borrowed by those who are able to use it to the best advantage. It does not create capital ; it enables capital to be employed more effectively. It has made possible very many undertakings which require for their creation and upkeep an amount of capital which no individual could have supplied himself, and in the construction of which the cost could not have been met from the current revenues of the State. Countries have been developed and international trade expanded by public credit. In countries with a developed system of credit the exchange of wealth is facilitated to the lasting good of the country concerned. Others which have been the victim of calamities such as war and earthquakes have been able to obtain funds to restore them to normality. Increased funds have been made available, especially for the younger and undeveloped countries. Again, credit increases the

¹ *The Wealth of Nations*, Bk. V. ch. iii., Cannan edit. vol. ii. p. 395.

national capital available for investment. The working and middle classes, as we have seen, find a profitable investment for their savings. Were it not for banks and issue houses much capital would not have come into use but would have been hoarded. In regard to war public credit has indeed been of vital importance, as without public credit no war could be waged for any length of time. "Defence is of much more importance than opulence", and countries have thus been able to preserve their culture and defend their ideals by means of public credit. Public credit also broadens the outlook of men. "A creditor of the public has no doubt a general interest in the prosperity of the agriculture, manufactures and commerce of the country; and consequently in the good condition of its lands, and in the good management of its capital stock."¹ Trade is benefited because as a rule the proceeds of a loan have beneficial effects on the balance of payments. The regular payment of interest and the repayment of principal prove a steady factor in the foreign exchanges.

With these very marked advantages there are one or two disadvantages which cannot be overlooked. The chief of these is the tendency to over-borrow on the part of the State and to saddle posterity with burdens by the incurring of expensive capital schemes. Especially in young countries public credit has sometimes been used overmuch, and this in turn has necessitated, as in Australia, a complete overhauling of capital expenditure and its control by an independent financial body representing in Australia the Commonwealth and the states. Some European States have incurred obligations beyond their taxable capacity, with the result that default or repudiation has taken place. In the case of external loans for unproductive works which do not produce their own interest and amortisation of capital, the payment by the debtor nation to its creditor has necessitated an increasing part of the national income, of the former being transferred to the latter to meet foreign payments, and this in turn in the post-War period has led to heavier taxation and to further borrowing. The burden becomes all the greater if there is, since the contraction of the loan, a fall in the general level of prices. The history of post-War Germany is an example of the tendency which public credit has in encouraging extravagance especially

¹ *The Wealth of Nations*, Bk. V. ch. iii., Cannan edit. vol. ii. p. 413.

among local authorities. This danger of over-borrowing is accentuated by the increased facility by which public loans can be raised to-day. From 1924 to 1930 Germany borrowed abroad (net) nearly 18,000,000,000 marks and 25,000,000,000 marks (gross) (£860,000,000 and £1,200,000,000 respectively), while its total reparation payments were 11,000,000,000 marks. Not less than 40 per cent of this was actually borrowed at short-term, and it thus placed Germany in a most dangerous international financial position, as became obvious in the summer of 1931. If a State over-borrows it will be impossible to meet the annual obligations of the Government, as these obligations may be beyond the taxable capacity of the taxpayers and the inevitable result must be default or repudiation. In a subsequent paragraph another disadvantage of public credit is discussed—the evil results of inflation following on the creation of purchasing power by bank credits. It will be clear how, when the amount of money obtained by taxes or by public loans falls temporarily below the urgent demands of the fighting services and ammunition factories, Governments have to turn to bank credit to fill up the gap between income and expenditure. The alternative is, as in Germany in 1922 and 1923, direct resort to the printing press. The effect of the creation of bank credits is to give the Government greater purchasing power and thus to curtail the real value of the purchasing power left to individuals. State borrowing in normal times must never be such as to lead to the starvation of industry. The first limit to the absorption of capital by the State must be the normal business requirements of the country. In abnormal times industry may and does have to be content with a mere fraction of its ordinary requirements. The State, however, must keep its borrowings within the limits set by the amount of capital which can be saved by the people. The amount of loans borrowed abroad will depend on the state of the national credit, the nature of the expenditure on which the loan is to be spent, and on the past financial history of the country in regard to payment of interest and capital.

There are one or two peculiarities of State borrowing which require emphasis. The rules that govern the borrowing on the part of an individual are generally similar to that of the State. There are, however, certain points of difference. A State, unlike an individual, does not die. Hence public credit may be con-

sidered permanent, if the State wishes, the State being not bound to liquidate all its debt at any definite period. A State also possesses sovereign power and it can compel its subjects to contribute. Forced loans, however, have been, except in isolated and exceptional cases, discontinued since the seventeenth century, and since then Governments have usually relied on the voluntary long-term or short-term loans. The position of units such as local authorities is the same as that of private borrowers. They do not possess sovereign power. On account of its sovereignty the State may repudiate its debts. An important instance of this kind is that of the United States, which, under the Fourteenth Amendment to the Constitution, declared in 1868 that all debts contracted by the Southern states during the Civil War and any debts that may be incurred at any time in aid of any insurrection against the Federal Government, were void. Before this, in the forties, seventies, and eighties of the last century several states of the American Union repudiated their debts, as, for example, Mississippi and Florida, or, as in the case of Alabama and others, they defaulted. The main consideration underlying the repudiation or default was largely political, a move against corrupt government. The greatest repudiation in history was that of Soviet Russia in 1918, when over £3,800,000,000 of Government and Government-guaranteed debts were repudiated on the ground that the debts were repugnant to the new socialist order, as the debts were part of the capitalistic system of private property and were "contracted by the Government of Russian landowners and Russian bourgeoisie". The debts to the Allies' Governments were repudiated also on the ground that they have been incurred in financing of a war in which Russia had little at stake as compared with her Allies. All wise Governments, however, realise that the sanctity of contract is a fundamental principle of capitalistic society, as constituted to-day, and how delicate credit is. Anything likely to shake the credit of a country must be sedulously eschewed. The financial position of a State and local authorities is better known to investors than the position of private borrowers. The State and the local authorities must therefore keep strictly to the path of financial rectitude and maintain that cardinal principle—real budget equilibrium. A nation must pay its way and live within its means and so earn the respect of the world. This accounted for the rapid recovery which the Commonwealth

Government of Australia made between 1931 and 1935 as a borrower in the London money market.

5. TAXATION VERSUS LOANS

Public loans exercise a great influence on a country's national economy. Most countries could not have developed their resources as they have done without public loans, including loans in the case of the younger and undeveloped countries from the older creditor countries of the world. To-day many countries are paying a considerable portion of their annual revenue as service of the public debt. The problem arises how far should public expenditure be met from taxation and, on the other hand, from loans. As has been shown in Chapter XI. of Book II., regular recurring expenditure must be met from taxation. Expenditure on productive works is usually met, sometimes from loans and to a smaller extent from revenue. The real difficulty arises with regard to unremunerative occasional expenditure such as wars, occasional catastrophes such as earthquakes and famines, and also the cost of some great reform such as the abolition of slavery, which necessitated the raising of the West India Slave Compensation Loan, 1835, of £20,000,000 as compensation to slave-owners by Great Britain. From 1688 to 1856 Great Britain incurred on wars £1,212,000,000, of which over seven-twelfths were from loans (£711,000,000) and less than five-twelfths (£501,000,000) from taxation. In the Great War in most belligerent countries from two-thirds to four-fifths of the total fiscal cost were met from loans. Germany actually paid 85 per cent of the cost out of loans, no doubt on the ground that payment of war indemnities would liquidate the loan.

Among the classical economists Ricardo uncompromisingly objects to meeting war expenditure by loans. He holds that such expenditure should be met immediately from taxes. His view is a perfectly clear and logical one, although to-day it would be impossible to raise taxation to meet the huge expenditures which war necessitates. To borrow is, in Ricardo's view, to create a permanent deficit. Borrowing makes an inroad into capital. It makes interest rates rise and wages fall. The total expenditure of a country is made up of private expenditures and public expenditures. Taxation is the only means of keeping down private expenditures when public expenditures increase.

If private expenditures are not decreased in this way poverty will follow. To the practical financier Ricardo's view is impracticable. He will point out that no taxation system will bear the strain of so huge an increase any more than the taxpayers themselves; that Ricardo fails to differentiate between short-term and permanent borrowing; and he does not appreciate the differential burdens of internal debts as theory has elaborated to-day. Gladstone also supports Ricardo's view. "The expenses of a war", said Gladstone, "are the moral check which it has pleased the Almighty to impose upon the ambition and the lust of conquest that are inherent in so many nations. The necessity of meeting from year to year the expenditure which it entails, is a salutary and wholesome check making them feel what they are about and making them measure the cost of the benefit upon which they may calculate." On the other hand, there are those who will borrow at the beginning of a war all the additional expenditure. Thus Adams put forward a plan that in the first year of the war the whole, in the second year a greater, in the third year a smaller part, and in the fourth year none of the cost should be made from loans. The whole cost, therefore, should be met after the third year by taxation.¹ Seligman took the view in regard to the expenditure of the Federal Government of the United States in 1918 that "It would have been necessary not only to take by taxation most of the smaller incomes and virtually all the larger incomes, but also to confiscate virtually all of business profits, and finally, after levying crushing taxes on consumption, to take such part of the existing private property of the United States as could find a ready market abroad".² Some other writers have suggested that the whole of the extraordinary expenditure in war should be met by loans, but its loans should be for a short period only, say fifteen or twenty years. If the burdens are distributed over a short period of years, each generation will have to bear its share in order to keep the public debt from rising to astronomical heights. This method of financing war expenditure would apply to other extraordinary and unremunerative expenditure which should be distributed, it is held, over the shortest possible period without necessitating an excessive increase of taxation.

¹ Compare H. C. Adams, *Public Debts*, p. 141.

² Seligman, *Essays in Taxation*, 9th edit. p. 744.

The best method of attacking the problem is to go back to Adam Smith. "The want of parsimony in time of peace, imposes the necessity of contracting debt in time of war. When war comes, there is no money in the treasury but what is necessary for carrying on the ordinary expense of the peace establishment. In war an establishment of three or four times that expense becomes necessary for the defence of the state, and consequently a revenue three or four times greater than the peace revenue. Supposing that the sovereign should have, what he scarce ever has, the immediate means of augmenting his revenue in proportion to the augmentation of his expense, yet still the produce of the taxes, from which this increase of revenue must be drawn, will not begin to come into the treasury till perhaps ten or twelve months after they are imposed."¹ "An immediate and great expense must be incurred in that moment of immediate danger, which will not wait for the gradual and slow returns of the new taxes. In this exigency Government can have no other resource but in borrowing."² Adam Smith, who is neither a supporter of "all tax method" of financing nor of the "all debt method", but of both, is aware that taxation cannot be violently changed; that taxes must be increased and new taxes added to the old; that these taxes must be used to pay interest and also the capital of the debt. Even if there is a surplus of revenue it will probably be inadequate to pay off the debt within any period during which it is likely that peace may continue. He also realised that loans or funding makes the present taxation so much less burdensome, and private incomes being thus less burdened, accumulation is so much less hindered. "If the method of funding destroys more old capital, it at the same time hinders less the accumulation or acquisition of new capital, than that of defraying the public expense by a revenue raised within the year. Under the system of funding, the frugality and industry of private people can more easily repair the breaches which the waste and extravagance of Government may occasionally make in the general capital of the society."³ Adam Smith's position in the phraseology of to-day would be to tax up to the hilt and borrow the rest, paying the service of the debt with the utmost regularity.

¹ *The Wealth of Nations*, Bk. V. ch. iii., Cannan edit. vol. ii. pp. 394-95.

² *Ibid.* Bk. V. ch. iii., Cannan edit. vol. ii. p. 395.

³ *Ibid.* Bk. V. ch. iii., Cannan edit. vol. ii. p. 411.

and at the same time paying off the principal at the earliest opportunity.

But this is not so simple a principle as it appears. Indeed the issue of taxation versus loans is far from easy of solution. The justification of taxes is that if the total cost of a war is met in this way, expenditure would be kept at a minimum. Public expenditure would be economical. Reliance on taxation avoids the dangers of some of the inflation resulting from credit, especially bank credit, and thus it avoids many of the problems of a post-War period. The levying of very heavy taxes would restrict consumption on the part of the taxpayers. It would reduce the capital ordinarily available for industry and therefore affect production. If the fixed capital already in industry is allowed to depreciate this would undoubtedly affect production over a considerable period of time. Large loans, however, may also absorb a proportionately large amount of capital which would otherwise go into industry, and the effects may in some degree be similar. If taxes are levied this would mean the high contemporary taxation of the richer classes, who have a larger margin for taxation than the poorer classes. There is a greater amount of free income waiting in the case of the richer classes for the tax-gatherer, not proportionately greater but progressively greater. If loans are employed extensively this will mean the avoidance of the heavy taxation of the rich, because in war-time heavy taxation must mean the taxation of the rich. When subscriptions are made to loans, subscribers hope that the interest which they will get will be greater than the amount of taxes which they will be required to pay, as no taxation system has yet been devised which takes the whole of the free income of the richer classes. Subscribers to loans, therefore, conclude that a loan will hit them much less than the equivalent in taxation. In other words, they are likely to put on a spurt to work harder and even to check their consumption in order to make it possible to subscribe in as large a measure as possible to loans. High taxation may and probably would curtail or damp the enthusiasm of these influential sections of the population, and this would seriously interfere with the conduct of the war in the same way that low taxation and the failure to tax the rich by contemporary taxation might raise the antipathy of the less wealthy classes which again will interfere with the carrying on of the war. There are other factors of political and psychological

nature which have to be considered, and among these are (1) the total cost of the war and its proportionate duration, (2) the position of the money market, (3) the machinery of tax administration which cannot certainly meet extremely great fiscal emergencies such as a modern war would necessitate, and (4) political conditions prevailing in the country and abroad. In the Great War, for example, some of the richest parts in France were the scene of action and were incapable of yielding any taxes. The French Government, too, recognising the peculiar dislike of the French people to direct taxation, postponed the introduction of the new and complicated system of the taxation of income. It is to be remembered that in time of war the alternative between taxes and loans presents a different aspect from that of peace-time.

The problem of loans versus taxes has also to include the question of the nature of the loans whether they are external or internal. The fact that about 15 per cent of the fiscal cost of the War was met through inter-governmental loans in the Great War raises the question of the burden of external loans, which is dealt with in the following chapter. If the loan is external and raised to pay for raw material and other forms of munitions, the burden will not fall at the time of the raising of the loan on the borrowing country but on the creditor country. For the payment of interest on external loans, part of the production of one country is transferred to income receivers in another country. In war-time, when munitions are being turned out in great quantities and unemployment is low or non-existent, the burden of paying interest on war loan may be comparatively light; but when the period of depression comes and prices fall, the burden grows and the payment from the national income of the debtor country to the creditor country may be so great as to interfere with its whole economic and financial structure, and make default or even repudiation essential.

So far nothing has been said as to the shifting of the burden to future generations by the resort to loans. This sometimes is spoken of as the time distribution of the burden. It cannot be said without qualification that the resort to loans places a burden on the shoulders of future generations. If the financing is done by taxes it does not necessarily confine the burden to the war generation. The levy of taxes may be so heavy as to affect consumption and therefore the present generation. But as already

shown it may reduce the capital available for industry to such an extent that production in the future will be affected, and future generations will not have the means to produce as efficiently as otherwise would have been the case. The resort to loans, as we have seen, may divert funds which otherwise would have gone into private sources and led to development of production. Indeed loans might affect the present production as in the last War. It curtailed the consumption of many investors anxious to subscribe to their very utmost to the loans, and therefore in so far as consumption was curtailed loans may be said to have affected the generation subscribing to the loans. Heavy taxes may impede the process of production, while on the other hand, the resort to loans may create conditions favourable to expansion and rising prices and thus lighten considerably the burden on the present War generation. It is therefore necessary, in speaking of the shifting of war burdens by loans to future generations, to examine with care the various results brought about by both taxes and loans. On the whole it may be said to involve a transfer of accounts from the subscribers of the loans to those who have to pay the taxes for the service, including the repayment of the capital of the debt, rather than to say that it is a shift of the burden to future generations. The present generation buys the loan and has to meet the interest and perhaps the repayment of the loan if it is a short-term loan. Future generations may also have to pay the interest, but if the loan is a long-term loan also the repayment of the principal. The repayment of the principal brings the holder of the (internal) loan no benefit and to the taxpayer no loss. The latter is relieved of the annual contributions out of income to the bond-holder. Whether it is the payment of interest or the repayment of capital, it is simply a question of transfer from the original subscribers to the loans to those taxpayers who pay the service and liquidation of the loans.

6. FINANCE BY BANK CREDITS—INFLATION

Finance by bank credits leads to inflation. By inflation is meant an increase in the general price-level resulting from an increase in expenditures, while goods available for purchase do not increase in a corresponding degree. An increase in Government expenditures, even if large, does not necessarily lead to

inflation provided the Government has recourse to taxation. The increased demand for goods and services on the part of Government then approximately balances the decreased means of purchasing on the part of the taxpayers. Taxes balance budgets, and inflation in the case of balanced budgets is rare. Even if a Government has recourse to a policy of borrowing the result may not be inflationary. If the lenders to Government curtail their own expenditures equal to the sum lent to Governments, there would merely be a change in the distribution of the demand for goods. Unfortunately individuals do not decrease expenditures by amounts equal to the amounts lent to Government. Governments, in addition to raising funds by taxation and by public loans, may find it convenient, especially in an early stage of an emergency, to use banks, usually the Central Bank. They may be afraid of high taxation and also of loans because the high rate at which they borrow might show their weakness even in the eyes of neutrals. They therefore have recourse to bank credits. The effect of creating bank credits either for the Government directly or for individuals subscribing to loans or who have taxes to pay to Government, is to give the Government greater command over purchasing power, and thus to decrease the real value of the purchasing power left to private individuals. It enables the Government to have increasing purchasing power at the expense of the general public, to get possession of more stocks of goods and services, and this becomes in other words a concealed form of taxation. It falls on the poor heavily. It is a tax proportionate to income and it thus hits the poorer classes, such as wage-earners, hard. The creation of bank credit, therefore, is much inferior to fresh taxation and ordinary loans.

In Germany during the War the Government borrowed from the Reichsbank, and it permitted the bank to place in its portfolio Treasury bills in place of commercial bills as cover for its notes. This was inflationary in its effect. When, too, reparations after the War had to be made, budget equilibrium became impossible and prices rose higher and higher and even moved more than circulation. In 1923 people became doubtful about the currency, and as a large employer said, when workers were paid their wages in the morning they returned in the afternoon asking to be paid in kind in place of the notes paid out in the morning. The value as a result of the inflation of the currency in 1923 changed not daily

but often hourly. In France the Government were forced to borrow from the Bank of France. These loans were not offset by a decrease in commercial loans and prices began to rise. Government purchases led to increased production, to a rise of prices, and this in turn led to demands for currency, chiefly paper currency, as soon as the Government cheques were cashed into notes at the Bank of France. In 1925 and 1926 the French Government by its neglect to take steps in time to check inflation was responsible for the flight from the franc. The large amount of unmanageable floating debt—in December 1925 eight short-dated bonds amounting to over two and a half millions of francs—fell due, which it was proposed to pay off not in cash but in similar bonds or in bonds which were to be accepted in the following year as the equivalent of cash in payment of direct taxes, with the exception of a new tax on profits. There was also a substantial budget deficit. The intoxication of inflation, out of which everybody seems to get richer, is a formidable psychological disease, and often is impossible of being cured until the intoxication has produced a condition of financial disablement. In the United States, as in India and most other countries, individuals were encouraged to buy on credit Government securities, and the banks lent on these securities without reducing their other earning assets. The result was the same as if the banks had lent loans direct to the Government. Reserve bank requirements of member banks were reduced and all reserves had to be held at the Federal Reserve Banks. Thus credit expansion was immeasurably increased. In short, everything was set fair for inflation. The pre-discount rates were also kept purposely low. In Great Britain a policy of inflation was also followed when the need of Government to finance war in excess of the amounts raised by taxation and by loans from the public necessitated the creation of credits in their favour at the Bank of England. "The balances", as the Committee on Currency and Foreign Exchanges after the War in their First Interim Report, 1918, pointed out, "created by these operations passing by means of payments to contractors and others to the joint-stock banks have formed the foundation of a great growth of their deposits, which have also been swelled by the creation of credits in connection with the subscriptions to the various War loans. Under the operation of these causes the total deposits of the banks of the United Kingdom (other than the Bank of England) increased from

£1,070,681,000 on the 31st December 1913, to £1,742,902,000 on the 31st December 1917.”¹ They also indicated that when before the War there was an effective gold standard, “the expansion of credit by forcing up prices involves an increased demand for legal tender currency both from the banks in order to maintain their normal proportion of cash to liabilities, and from the general public for the payment of wages and for retail transactions. In this case also the demand for such currency fell upon the reserve of the Bank of England, and the bank was thereupon obliged to raise its rate of discount in order to prevent the fall in the proportion of that reserve to its liabilities. The same chain of consequences, as we have just described, followed and speculative trade activity was similarly restrained. There was therefore an automatic machinery by which the volume of purchasing power in this country was continuously adjusted to world prices of commodities in general. Domestic prices were automatically regulated so as to prevent excessive imports; and the creation of banking could be safely permitted a freedom from State interference which would not have been possible under a less rigid currency system.”² In war-time this automatic action of the gold standard no longer operated. The Committee showed how the need of the Government for funds led to inflation following the great increase of the deposits in the joint-stock banks. When the Government received an advance from the Bank of England, Public Deposits were increased to the extent of the advance, and when the amount was paid out to contractors and other creditors of Government and when the cheques were cleared, the credit passed to the credit of these at the joint-stock banks and at the Bank of England to the credit of the bankers. The advance, in short, passed from “Public Deposits” to “Private Deposits” at the Bank of England, and the result was an increase in the hands of the public in the form of deposits to the extent of the advance in the joint-stock banks and at the Bank of England in the bankers’ cash by the same amount. The proportion of cash to liabilities of the joint-stock banks is increased with the increase in the bankers’ liabilities to depositors by the extent of the advance, and their cash reserves by an equal amount. The bankers

¹ First Interim Report of the Committee on Currency and Foreign Exchanges, Cmd. 9182, 1924, para. 10, cf. para. 6.

² Cf. para. 6.

accordingly are in a position to make advances to their customers to an extent equivalent to four or five times added to their cash reserves or, alternatively, in the absence of demand for accommodation, to increase their investments by the difference between the cash received and the proportion required to be held against deposit liabilities. "Since the outbreak of War it is the second procedure which has in the main been followed, the surplus cash having been used to subscribe for Treasury Bills and other Government securities. The money so subscribed has again been spent by the Government and returned in the manner above described to the bankers' cash balances, the process being repeated again and again until each £10,000,000 originally advanced by the Bank of England has created new deposits representing new purchasing power to several times that amount. Before the War these processes, if continued, compelled the Bank of England, as explained in paragraph 6, to raise its rate of discount, but, as indicated below, the unlimited issue of Currency Notes has now removed this check upon the continued expansion of credit."¹ Thus finance by borrowing from banks of Governments in order to meet their war expenditure led to a large rise in prices and to inflation.

7. FLOTATION OF LOANS

We have seen that there are some five methods of raising funds otherwise than by taxation. These are (1) by temporary loans from individuals or from banks ; (2) by permanent or long-period loans ; (3) by the issue of inconvertible paper ; (4) by the sales of Government property ; and (5) by utilising hoards of treasure. These last two methods are now unimportant as they can meet but the mere fraction of the initial expenditures for which they are required. The issue of inconvertible paper inflicts, as we have seen, incalculable loss on the community by the inflation of prices with its violent effects on the possessors of fixed incomes, and on the poorer classes from whom, on account of the change in the prices of the necessities of life, a relatively greater contribution is demanded. We have, therefore, really to consider only the

¹ Cmd. 9182, 1921; cf. footnote to para. 10, p. 4. For examples of inflation and how it works see Rogers, *The Process of Inflation in France, 1914-1927* (New York, 1929); Graham, *Exchange, Prices and Production in Hyper-inflation Germany, 1920-1923* (Princeton, 1930); Pigou, "Inflation", *Economic Journal*, vol. xxvii. (London, 1917); Elster, *Von der Mark zur Reichsmark* (Jena, 1928).

raising of funds for short and long periods. In regard to the former, floating debts enable the State to meet a temporary shortage of revenue in the course of the year. A fund is created thereby to help the Treasury. The danger is the tendency of the Treasury to become a great deposit bank at the expense of commercial banks, and although in normal times it is not dangerous in well-financed countries, in abnormal times it may necessitate borrowing on a considerable scale. The demands on the part of creditors may be so great that the Government may have to issue paper currency or to consolidate debt at much expense. It is therefore necessary to reduce the floating debt within manageable proportion, so that it can never be a source of great danger. It is better to borrow for a long term and to pay a higher rate of interest than to be perpetually at the mercy of holders of Treasury bills for repayment. If the holders of these bills do not renew them the Government has to accept a lower price for its bills, with reactions on the rate of interest. Alternatively Governments have to borrow from the Central Bank on Ways and Means. The floating debt in France has been a source of great embarrassment to the French Treasury in the post-War period, especially in 1925–26, 1932–33, and 1935–36, just as has budget balance. The Colwyn Committee sums up the dangers of a floating debt in words which deserve quotation. “The real dangers of a large Floating Debt would appear in the event of a future national emergency requiring Government borrowing on a considerable scale. In such a case an increase in the Floating Debt would be almost certain to occur, because expenditure naturally precedes any measure taken to increase taxation, or even to raise permanent loans. The fact that a large Floating Debt already existed would make it far more difficult to secure further short borrowing without recourse to measures which would involve serious inflation with all its harmful consequences. It has also to be borne in mind that the tendering for Treasury Bills is affected by the volume of foreign deposits in London.”¹

In the flotation of loans there are one or two principles which modern technique emphasises. In the first place loans must be

¹ Report of the Committee on National Debt and Taxation, Cmd. 2800, 1927, para. 101. For the decrease in British floating debts in recent years see Table 145, page 212, Statistical Abstract for the United Kingdom, Cmd. 4489, 1934.

floated at the market rate. This simple rule has been forgotten and Governments attempt to borrow at the expense of present and future taxpayers at rates below the market rate, by offering inducements to the lender such as the issue of a loan considerably below par or at par with redemption above par, or by a low rate of interest with money prices attaching to the issue or with tax exemptions attached to the security. The issue of a loan at a heavy discount assumes that interest rates will fall and the price-level will rise or at least remain constant. There is no justification for the issue of loans at a heavy discount instead of at par or not very appreciably below par, unless the State can secure advantages underlying the result in increase in the capital of the debt. In the reign of George II. instead of varying the interest upon the loan according to the state of the money market at the time, the rate was fixed at three and a half per cent, the necessary change being made in the principal. This resulted in greatly increasing the principal of the debt, which McCulloch in 1847 estimated was nearly two-fifths more than the sum actually advanced by lenders. It was argued that this rendered the management of the debt and its transfer simpler than if there were a number of funds at different rates of interest ; it has been argued, too, that the great field for speculation afforded to the dealers in stocks bearing a low rate of interest has enabled Government to borrow for less interest than would have been necessary had such increase not been made. But in war interest rises and is usually much higher than during peace. If then the loans were funded in stocks bearing a rate of interest equal to the market rate, it will be possible to convert when interest falls in times of peace and to avoid burdening the country with the payment of interest for an end of period. Before this can ever be considered, it must be shown that it is vitally necessary to secure some reduction in the current interest charges in the budget by the expense of increased capital charge. In regard to lotteries the inducements of prizes to selected holders of the loan are really high redemption premiums, and this has already been discussed. The inducement to give special privileges of exemption from taxation is frequently dangerous to taxation systems. In the United States, in view of the increase in Federal and local taxation, it has become nothing short of a menace. It means a great loss to the Federal and State Governments, which lose more

in taxation than they gain by a possible lower rate of interest. The states of the American Union are not free to tax Federal bonds either under their state income taxes or in their taxation of property, and the Federal income-tax authorities in turn do not tax state and local issues. This has only to be stated to show whether tax exemption has led to tax evasion in the United States. It creates a privileged tax-exempt class, the holders of securities, who being the richer classes benefit at the cost of the poorer classes. The privilege, too, is an unfair discrimination against private industrial capital, which must pay higher interest rates. If loans are floated abroad, exemption is justified. In the United Kingdom during the War, to attract capital for war purposes certain exemptions were given in one or two cases which are not likely to be repeated, viz. exemption of interest on certain loans from liability to assessment to British income tax other than surtax ; payment of interest without deduction of income tax at the source but with liability to assessment in the hands of recipients ; exemption of interest from income tax and surtax in the case of certain securities held by persons not ordinarily resident in the United Kingdom ; and exemption of securities from all taxation present or future including Estate Duty, so long as it is shown that the securities belong to persons who are neither domiciled nor ordinarily resident in the United Kingdom. The British revenue authorities have stated their policy in a memorandum as follows : " Tax concessions have been frequently advocated as likely to make a particular issue attractive, in effect as an alternative either to a higher rate of interest or to a lower issue price. But such a concession can only be ' attractive ' if the recipient both in fact receives, and still more thinks he is receiving, a bargain. Their radical defect from this point of view is the necessary uncertainty of their value to the recipient. He does not know what future rates of income tax will be, or, whatever the rate, what his future income will be, or (in the case of death duties) how soon and under what market conditions he will enjoy the privileges of tendering his securities at par (in lieu of market price) in payment of death duties. He naturally tends to estimate the advantages of a tax concession with a very safe margin in his own favour. In these circumstances it is hardly doubtful that the State does not in fact obtain in improved loan conditions anything approaching the real value

of the tax concessions it gives. At best it is entering on a doubtful speculation instead of, as in the alternative of, *e.g.*, a lower issue price, facing a certainty, the financial effect of which is known to both parties. Mainly for this reason the policy in recent years has been definitely to get away from war concessions and to refuse them to new issues. In principle, special tax exemptions are objectionable, (*a*) because they create special classes of persons free from general tax liabilities, (*b*) because it is very doubtful if the State in fact receives value for the tax concession, (*c*) because the concessions involve administrative complications. The only defence for such privileges is that in moments of emergency they may be unavoidable, and that in dealing with a National Debt of £7000 million it may be impossible to avoid second-rate financial expedients.”¹ There has been in the present century, especially since the War, an increasing democratisation in public loans. This has been rendered possible by the issue of loans in small denominations or in the form of special certificates. This has proved to be, in Great Britain, the United States, and other countries, a useful method of encouraging saving among the working classes. France had followed this policy as early as the last century.

In times of emergency it may be necessary, in addition to the method of stimulating the placing of public loans, to prevent the investor from using alternative methods of investment. This is usually done by prohibiting altogether the private investment of capital abroad and of limiting severely the investment abroad of such capital. Another method is to prevent the raising of capital for internal investment, except under Government licence. Private expenditures may be curtailed by restrictions in other directions, rationing the prohibition of imports of certain classes of goods. Expenditure may also be restricted from lack of transport. In addition to these negative methods, control by the State over capital in times of emergency, there is the positive method of forced loans which, in a modern capitalist State, may be permitted if voluntary loans are not likely to succeed. Forced loans, as has been pointed out, carry frequently a lower rate of interest than the market rate, and in this respect are inferior to voluntary loans. Forced loans are also inferior in that they may fall on those who with family and other encumbrances, or with other

¹ Report of the Committee on National Debt and Taxation, 1927, para. 172.

expenditures to meet in the near future, cannot afford without much hardship to pay the contributions. People with the same income have not always the same free income available for the tax-gatherer. Forced loans from the State point of view are also inferior to a tax because they contain a promise of interest and perhaps repayment of the capital. It must be admitted that in the War in some countries patriotic propaganda often made a voluntary loan a quasi forced loan. After the War, Governments decided to raise forced loans but voluntary subscribers came forward, so that these forced funded loans were unnecessary. In 1914 the Netherlands, in 1917 New Zealand, in 1918 the Commonwealth Government of Australia, in 1919 Italy, and in 1920 Norway announced forced loans which the Governments were able to float as voluntary ones. In the inflation troubles of 1922 Germany failed in its experiment of a forced loan, as did the states of Czechoslovakia, Poland, and Greece, which followed the attempt. In 1924 Hungary raised a 5 per cent forced loan, the yield on which in May 1932 was as high as 25·36 per cent. It will be invariably found from experience that forced loans show that the Government concerned has been following a very unsatisfactory budget policy and that the time for a thorough overhaul of the finances has been imperatively necessary. But the experience of the countries just quoted rather tends to show that in an emergency such loans may be justified if the country is a highly developed one.

CHAPTER XXXIII

THE BURDEN OF PUBLIC DEBTS

IN estimating the burden of public debt in the same country at different times or in different countries at the same time, certain facts have to be remembered. In the first place the nature of the debt has to be carefully considered—how far is it internal debt and how far external debt, and again for what purpose the loans have been contracted, *i.e.* whether the debt is deadweight debt or productive debt. The level of prices has also to be considered. This last problem assumes considerable significance in regard to post-War debts. Violent disturbances in prices have usually occurred after great wars and in times of great prosperity or the reverse. In the United States and in Great Britain between 1929 and 1933 the fall in the wholesale price-level was over 30 per cent, and in France during the same period 37 per cent. It has been officially estimated in the United States from the cost-of-living index of the Bureau of Labour Statistics that an income fixed in terms of money in 1913 had in 1920 only 46 per cent of the original purchasing power and in 1929 about 59 per cent, which rose to 72 per cent in December 1934. After the War as compared with the pre-War year the money debt of Italy increased 7 times, that of France 9 times, Great Britain 10 times, the U.S.A. 20 times, and Germany 58 times. The real burden of debt, however, when these differences in the purchasing power of each currency, *i.e.* the changes in the general level of prices, are allowed for, shows that after the War Italy's real debts have increased only by one-fifth, that of France $2\frac{1}{2}$ times, Great Britain 6 times, Germany 3 times, and the United States 13 times. This may be illustrated by the table on opposite page. From this it will be seen that on 31st March 1934 the capital of the National Debt was 11·4 times the size of the debt in the pre-War year,

but measured in pre-War prices it was 10·9 times. The real burden arises in regard not to the total amount of debt as it is not repaid in a lump sum during the year, but to the annual charge

TABLE SHOWING THE TOTAL OF THE PUBLIC DEBT OF THE UNITED KINGDOM IN 1914-1920, AND OTHER YEARS, IN ACTUAL FIGURES AND REDUCED TO THE PRE-WAR PRICE-LEVEL

Date.	Public Debt		Board of Trade Index Number of Wholesale Prices	Public Debt reduced to Pre-War Price-level	
	Amount, £ (000,000 omitted)	Index Number.		Amount, £ (000,000 omitted)	Index Number.
31st March 1914	706·2	100	100*	706·2	100
1920	7,875·6	1,115·2	319	2,468·8	349·6
1921	7,623·1	1,079·5	211	3,612·8	511·6
1922	7,720·5	1,093·2	160	4,825·3	683·3
1925	7,665·9	1,085·5	166	4,617·4	653·9
1929	7,620·9	1,079·1	137	5,562·8	787·7
1930	7,596·2	1,075·6	120	6,330·2	896·4
1931	7,582·9	1,073·7	104	7,291·2	1,032·4
1934	8,030·4	1,137·1	104	7,721·5	1,093·4

* 1913.

for the service of the debt. It is here that the effect of the price change on the burden is evident. With a fall in prices there is no reduction in the interest charges except in so far as the relation of interest and prices enables conversions to be made. As the price-level falls, the burden of interest increases, taking as it does a larger proportion of production to meet the interest payment. The lender of the loan receives a relative as well as an absolute increase in purchasing power when prices fall ; and on the other hand, when prices rise without a compensating fall in production, he receives a relatively less purchasing power.

With a fall in prices, therefore, the ratio of debt interest to national income increases. In Great Britain, for example, the ratio in 1920 was 5·5 per cent (internal debt interest £309,000,000 and national income £5,600,000,000), and in 1923, *i.e.* within only three years, it rose to 7·1 per cent (£270,000,000 and £3,800,000,000), or an increase in burden of 29 per cent. The likelihood of a considerable fall in the price-level after a war is a strong argument for repaying as much debt as possible before the fall occurs. It also proves how strong was the case for a capital levy in Great

Britain after the War when the general level of prices was high. When prices fall, the case for such a levy is no longer so strong.

In measuring the burden of a debt either in the same country at different times or in various countries at the same time, the knowledge of the national income and of the national wealth is required. But unfortunately the data for these are not available on strictly comparable lines, and this makes the calculation of the burden all the more difficult.

I—PUBLIC DEBT IN TERMS OF NATIONAL WEALTH

Country.	Unit (Millions).	National Wealth *	Public Debt.	Percentage of Public Debt to National Wealth.
Great Britain . . .	£s	20,000	8,030	40·2
France . . .	Frances	1,200,000	319,831†	26·7
Italy . . .	Lire	611,000	105,164	17·2
Canada . . .	\$	25,000	2,730	10·9
India . . .	Rs.	150,000†	12,124	Prod. 5·3 Unprod. 2·8
The United States .	\$	355,000	27,053	Total 8·1 7·6

* The figures of national wealth relate approximately to the period just before the trade depression (1929–30), later figures not being available.

† This figure for India has been estimated at Rs 15,000 crores or £10,000 millions. In the estimate of Rs 15,000 crores or £10,000 millions are included real property (land and buildings), railways, gold and silver coin and bullion, jewellery, agricultural products, live stock, manufactured products, minerals, imported merchandise, manufactured machinery and tools, telegraphs, telephones, tramways, and miscellaneous. Sir Robert Giffen's rough estimate of £3000 millions was made in 1903 (*Economic Enquiries and Studies*, vol. II London, Bell and Sons, 1904). Since Giffen's estimate was made prices have risen, and with increased development, especially since 1904–5, there have been an increase in wealth (see Table XXVI, App.). Cf. Professor Corrado Gini's article, "Quelques chiffres sur la richesse et les revenus nationaux de quinze Etats" (*Métron*, vol. III, 1923). The wealth of India is given at 150–185 milliard francs (£6000–£7000 millions at 25 fr.=£1).

‡ This excludes War debts, Fr. 192,000 millions.

II—PUBLIC DEBT CHARGES IN TERMS OF NATIONAL INCOME

Country.	Unit (Millions).	National Income	Public Debt Charges.	Percentage of Debt Charges to National Income
Great Britain . . .	£s	3,500	224	6·4
France . . .	Frances	210,000	11,226	5·3
Italy . . .	Lire	93,936	7,224	7·7
Canada . . .	\$	5,938	142	2·4
India . . .	Rs.	16,000	169	1·1
The United States .	\$	48,894	1,117	2·3
Japan . . .	Yen	13,382	394	2·9

Statistics of *per capita* debt are apt to be misleading, especially when the standard of living in the countries compared varies

greatly, as, for example, that of China as compared with that of the United States. If the *per capita* figures alone are taken, the relative income and wealth of the two countries are omitted. Nevertheless the *per capita* figures are of value especially when studied in conjunction with the total internal and total external debt of each country. The table below, for example, shows the extreme lightness of the German debt as compared with that of Great Britain, France, and the United States. *Per capita* figures, if shown for external and internal debt separately, are also of interest.

III—*PER CAPITA* DEBT FOR CERTAIN COUNTRIES OF INDUSTRIAL IMPORTANCE

Country	1900	1913 (Pre-War Year)	1924	1934.
	£ s.	£ s.	£ s.	£ s.
Great Britain . . .	15 8	15 10	174 2	173 8
India . . .	17	1 5	2 7	2 12
Canada . . .	10 8	9 0	55 10	60 10
Australia . . .	53 14	64 10	165 15	146 14
New Zealand . . .	58 12	91 10	162 16	162 0
South Africa . . .	..	88 10	116 19	152 2*
The United States . . .	3 8	2 10	42 6	44 0
France . . .	28 4	34 4	281 17	158 6
Germany . . .	2 2	16 3	159 10	14 14
Japan . . .	1 4	5 1	4 6	7 15

Note.—Conversions have been made at the average rate of exchange for each year. Federal debt only is included. In Australia if State debt is included the *per capita* debt would be £184 : 14 : 0. Local debt is excluded in all cases.

* European population only.

The growth of population, the increase in wealth, and public assets available for liquidation have also to be remembered in comparing one year with another and one country with another. The total amount of debt in the case of one country may be the same as in the case of another country, but if the loans in one country have been floated considerably below par and the loans in the other country at par, the real burden of debt in the case of the former would be higher than that of the latter. Thus the burden of debt in France is higher as compared with most other Continental countries, and this is attributable to some extent to the fact of France having issued loans considerably below par. The actual rate of interest in the case of France would be different from that in some other countries, as loans in France have been

issued much below par. The real burden of debt, other things being equal, is thus higher in the case of France.

IV—THE PUBLIC DEBT OF GREAT BRITAIN AND OTHER COUNTRIES

Country	Unit of Currency	Total Capital of Debt (Millions)				
		1914 (Pre-War Year).	1924	1934.	Percentage Increase in 1934 or Decrease (-) over	
					1914	1924
<i>Europe :</i>						
Great Britain . . .	£	706	7,708	8,030	1037	4
France . . .	Franc	34,188	270,708	511,831	1397	89
Belgium . . .	Franc	4,627	40,680	56,715	1126	39
Germany . . .	R.Mark	5,158	2,744	12,407	141	352
Netherlands . . .	Guilder	1,162	3,454	2,701	132	-22
Italy . . .	Lira	15,766	93,163	105,164	567	13
<i>Asia :</i>						
India . . .	Rupee	5,513	9,561	12,240	122	28
Japan . . .	Yen	2,561	4,770	8,683	239	82
<i>Oceania :</i>						
Australia . . .	£	510	1,010	1,223	140	21
New Zealand . . .	£	92	219	303	229	38
<i>Africa :</i>						
Union of South Africa	£	126	192	274	117	43
<i>America :</i>						
Canada . . .	\$	336	2,820	2,730	712	-3
United States . . .	\$	1,188	21,251	27,053	2177	27

The comparison is thus misleading and therefore the comparative burden of the debts. Moreover the rate of interest in the countries compared may be far from being identical, as is shown on opposite page.

Sometimes the proportion of the expenditure for the debt services in relation to the annual budget is taken as an index of the burden of the debt. This, however, in itself is incomplete, especially as it leaves out of account the nature of the debt and the relative resources in the countries compared. The Chairman of the American Funding Commission, in January 1926, announced that War debt burdens were settled on the principle of capacity to pay, and he took the proportion which the War debt expenditure formed of the total budget expenditure in each country. The

comparative burdens were 4·6 per cent for Great Britain, 3·5 per cent for Belgium, and 5·17 per cent for Italy. He also gave the percentages which the annual payments were to national

V—THE PERCENTAGE YIELD OF BONDS

Country.	Nature of Loan	Actual Percentage Yield (Jan 1935)
<i>Group I—2½% to 3½%</i>		
United Kingdom . . .	Consols 2½%	2·73
The United States . . .	Treasury bonds	2·83
Union of South Africa . . .	5% inscribed (London)	2·95
Egypt . . .	4% unified debt (London)	2·95
Sweden . . .	Government bonds	3·01
Australia . . .	5% registered (London)	3·44
British India . . .	3½% Government stock (London)	3·5
<i>Group II—3½ to 5%</i>		
France . . .	Rente perpét. 3%	3·60
Canada . . .	Province of Ontario	3·65
Netherlands . . .	Government bonds	3·93
Switzerland . . .	Government 3½% (Fed. railways)	3·96
Argentine . . .	4% Recession bonds (London)	4·08
Belgium . . .	Rente belge 3%	4·10
Italy . . .	Rendita 3 5%	4·22
Japan . . .	Public bonds (average yield)	4·58
	6% 1924 loan (London)	7·15
<i>Group III—5% to 6½%</i>		
China . . .	5% Reorg. Loan 1913 (London)	5·05
Germany . . .	Obl. hypoth. 6% and 6% mortgage bonds	6·23
	7% Dawes Loan (London)	9·75
<i>Group IV—6½% and upwards</i>		
Brazil . . .	5% 1914 Fund (London)	7·2
Hungary . . .	7½% 1924 loan (London)	7·5
Poland . . .	Forced loan 5% 1924	10·53
Uruguay . . .	\$ loan 1919–20 6%	7·98
Chile . . .	5% 1919 loan (London)	10·53*
Greece . . .	6% 1929 loan (London)	12·00†
	7% 1924 Refuge loan (London)	17·00‡

* Last quoted 1933 (October).

‡ Last quoted 1932 (April).

† Last quoted 1931 (July).

income, and these were for Great Britain 0·94, for Belgium 0·80 and for Italy 0·97. The figure, however, for Italy was estimated at £40,000,000 in the first twenty years or an average of £2,000,000 per annum, according to calculations worked out by the City

Editor of *The Times*, which was equal to 1·29 per cent of Italian Budget expenditure and 0·24 per cent of Italian national income, and this meant that the burden of the British War debt settlement was four times as heavy as the Italian. For War debts still another index was taken. Expressed as a percentage of foreign trade which is an index of capacity to transfer payments abroad, the British settlement was equal to 1·9 per cent, the Belgian to 0·88 per cent, and the Italian to 2·87 per cent. The following summary table is of interest :

VI—PERCENTAGE OF EXPENDITURE ON DEBT SERVICES
TO TOTAL ORDINARY EXPENDITURE

Country	1933-34.
	Percentage.
New Zealand . . .	55·4
Australia . . .	50·9*
India . . .	27·5 (1)
Canada	44·4*(2)
Union of South Africa . . .	27·0*(1)
Italy . . .	40*
Great Britain . . .	36
Belgium . . .	31·3
France . . .	28·8
Switzerland . . .	24·6
United States . . .	21·6
The Netherlands . . .	19·6
Germany . . .	15·4*(3)
	13·6
	10·2

Source : *Statistical Year Book of the League of Nations*, 1934-35.

* Federal only (1) Federal and units. (2) Mainly productive debt. (3) Expenditure includes ordinary and emergency expenditure

Other methods have sometimes been suggested such as a comparison of the actual or market value of the debts. The market price refers only to a small amount of the total debt that is in the market for sale. A comparison based on the relative proportion of internal and external debt is also difficult. Sometimes the burden of debt interest is measured in terms of foreign exchange income from invisible items or in terms of the export receipts. Thus in June 1934 the British Government informed the German Government that there was no substantial strain on the interest payments on the Dawes and the Young Loans by showing that Germany's foreign exchange income, from invisible items, on the German estimates was 250,000,000 marks a

year, so that the interest on the Dawes and the Young Loans would require less than two-fifths of the receipts from these resources, exclusive of any call on German export receipts. The exports receipts, it was pointed out, averaged 350 to 400 million marks per month, so that the interest on the Dawes and Young Loans is only 2 per cent of the gross foreign exchange income of Germany from all sources.

The upshot of the matter is that any one of these methods of estimating the burden of a public debt taken by itself is unsatisfactory. A combination of methods is essential before definite conclusions can be made in regard to the relative burden of the public debt in the same country at different periods or in different countries at the same period. The proportion of debt charges to the total ordinary public expenditure in the Budget and to national income, *ceteris paribus*, are the most useful methods of estimating burdens. In the case of external debt the burden is usually measured in terms of the foreign exchange income derived from the balance of payments of the country concerned.

The burden of a productive debt, whether internal or external, differs from the burden of an unproductive debt, both internal and external. Thus India's public debt position compares more than favourably with the debt position of every other country because its public debt is self-supporting. Taking the average of the five years ending 1933-34, the gross interest charge on the debt has been Rs.42.06 crores (£31,624,000) per annum, and only 3 per cent of this Rs.1.26 crores (£948,720) had to be met from general revenues. A productive debt is incurred for the economic development of a country, and the expenditure connected with it creates a fund for paying the interest and also repaying the capital. If the profits of the concern meet this, there will be no real burden whether the creditor is living within the state or whether he is abroad. In this case no general principle can be laid down when to borrow within the country or abroad. It depends on the situation of the borrowing country. A country may require capital for expansion of its undeveloped resources, and may find it expedient to borrow abroad if its progress is not to be impeded. A country may not be able to get the small men to invest their savings for the further development of the country's resources. It therefore has to face practical realities

and has recourse to loans abroad in place of the far greater evil of holding up the proper development of the country. It has, however, to realise that the market is strictly limited in regard to the total amount that can be raised, and it has to compete for loans at the most opportune moment. It is not derogatory to the dignity of a country or evidence of the weakness of its position that it has recourse to external loans. A highly developed country like the United States borrowed largely, until the Great War, for financing railways and other enterprises, in the London money market. In 1914 British investments in the United States, mainly in railways, were £760 million. Many railways in South America have also been built with capital raised in England. India has borrowed British capital to the extent of £650,000,000, mainly for railways, irrigation works, and industrial development. Japan and other countries requiring capital also borrow freely, but at higher rates than India, in London and in New York. The main point to remember is that even this productive debt must be discharged with scrupulous regularity, and no over-borrowing of any kind in the well-financed state should be tolerated. There must be no overstraining of the credit of the country. Enterprise and enthusiasm must go hand in hand with caution and self-control.

Next with regard to unproductive debt. Here no fund of new wealth is created out of which interest and repayment of the debt can be regularly made as in the case of productive debt. If the debt is borrowed for unproductive purposes internally the results will be different from borrowing externally. When a country borrows abroad for unproductive purposes, such as a war, it uses up immediately resources of the foreign lender which may be in the form of food or munitions of war. The borrowing country has to meet the interest from the country's production, *i.e.* from taxes year by year, and this is an equivalent to the export of goods and services which do not pay for any imports in return. In short, the wealth of the borrowing country is being used up year by year in part in the payment of interest and the repayment of principal. There is no immediate burden in an external unproductive debt as in the case of an internal unproductive debt. There are, however, disadvantages. In the first place, it is a levy on production year after year, and the proceeds are transferred out of the country to the creditor

country abroad. Secondly, the whole burden of the debt can only be assessed when the debt is paid off, and this may be spread over a very long period. The burden will be heavier or lighter, *ceteris paribus*, as the purchasing power of gold over labour and capital in the borrowing country increases or diminishes. The country may have to repay the debt considerably in excess of what it borrowed owing to this change in purchasing power. Thirdly, in addition to the direct money burden, the amount paid to the foreign country by the borrowing country by way of interest and repayment of principal, and the direct real burden, the loss of economic welfare of the debtor country, there is the indirect burden brought about, for example, by the taxes required for the debt charges, which may be so high as to check the productive powers of the community. An external loan may be unavoidable, the alternative being the use of the printing-press inflation, or it may be, in the exigencies of the War, the only means of financing the purchase abroad of munitions which are vitally necessary to the borrowing country.

Internal unproductive debt involves a transfer of purchasing power within the country and is in contrast to an external debt which involves a transfer of goods and services to other countries. We have to be careful not to entertain the idea that heavy internal borrowing does not matter because it is a transfer and leaves behind it no real burden. Heavy taxation to pay the interest and the repayment of the loan may mean heavy burdens and this may interfere with the productive powers of the community, especially in an industrial country requiring regular supplies of capital. Melon, in his *Essai politique sur le commerce*, 1734, an English translation of which was in Adam Smith's library,¹ held the internal borrowings of a nation to be "debts of the right hand to the left", and that they had no tendency either to increase or decrease national wealth. Hume in his *Essay on Public Credit* quoted this, as did Adam Smith in his *The Wealth of Nations*,² only to condemn it because of the heavy taxation

¹ *A Political Essay upon Commerce*, written in French by Monsieur M——. Translated, with some annotations and remarks, by David Bindon, Esq., 8vo, Dublin, 1739. ("Catalogue of Adam Smith's Library", Bonar, London (Macmillan & Co.), 1932, p. 113.)

² "In the payment of the interest of the public debt, it has been said it is the right hand which pays the left" (*The Wealth of Nations*, Book V. ch. iii. Cannan's ed. vol. ii. p. 412).

on land and capital. The taxation of the land would affect detrimentally agriculture ("as the distress of the landlord increases, the agriculture of the country must necessarily decline") and holders of capital would shift their capital elsewhere. When "All or the greater part of the employers of great capitals, come to be continually exposed to the mortifying and vexatious visits of the tax-gatherers, this disposition to remove will soon be changed into an actual removal. The industry of the country will necessarily fall with the removal of the capital which supported it, and the ruin of trade and manufactures will follow the declension of agriculture."¹ An internal debt uses up immediately a certain amount of a country's resources. There is the immediate burden of expenditure, the consumption of the national wealth owing to the expenditure that must be incurred. The tax burden on the individual is postponed and the subscriber to the loan receives a claim to future goods and services. He has a call on future taxation levied on himself and his fellow taxpayers. Were extra savings possible equal to the total of the loans and taxes demanded by Government it would avoid economic damage. Such extra saving in ordinary or even extraordinary times is not likely to be equal to these increased demands on the national wealth. There is, therefore, economic damage which may take place in several directions: Potential capital which normally would have gone into industry, is used up, existing capital is depleted and foreign securities in the debtor country may have to be realised in order to pay off debts to the creditor abroad.

The burden of the internal debt itself does not destroy wealth; it merely redistributes it within the community. There is an annual transfer of wealth for the payment of the interest and the repayment of capital. It adds to the potential saving and purchasing power of the interest receivers what has been taken from the taxpayers. In many cases the income receivers are the taxpayers themselves. If the internal debt results in a greater inequality of income, there would be a direct real burden on the community. This is so if the wealthier classes are taxed less than the proportion of the debt held by them. If, on the other hand, the wealthier classes pay more than the interest on public securities held by them, there would tend to be a direct real

¹ *Op. cit.* p. 413.

benefit as this would make for the decrease of the inequality of incomes. It is no easy matter to come to a decision in regard to this point in the case of any individual country. Thus in 1933 in Great Britain the total income tax payable by individuals (who are the wealthier classes of the community) amounted approximately to £250,000,000—incomes up to £500 paying £23,000,000, incomes from £500 to £1000 paying £35,000,000, incomes from £1000 to £2000 paying £40,000,000, and incomes exceeding £2000 paying £152,000,000. In addition to income tax (£250,000,000) and surtax (£60,000,000) an Estate Duty and Legacy and Succession Duties amounted to £76,000,000. The total service of the National Debt now is £224,000,000. Thus in Great Britain the net produce of income tax, surtax, and death duties exceeded the interest on the National Debt by £162,000,000, which were used for general Government services. It is, of course, clear that, had the War been financed out of taxes so that no great internal debt would have remained, the income tax paying classes would have been called upon to pay considerably more to the general services. Thus to this extent loans have enabled these classes to escape at the expense of poorer classes a heavy burden which, had taxation been used to a greater extent, they would have had to bear. At the same time it is certain that income tax payers in Great Britain are paying their own debt interest, and in this way may be said to get no money return from their investment. The wealthy who pay high progressive taxes are particularly hit, as they are getting in reality no money return and their income and saving are decreased in a large degree. Socialist writers, like Dalton, are of opinion that the transfers of wealth involved in the services of an internal debt are transfers from the poorer to the richer classes and also transfers on balance from the younger to the older generations, from the active to the passive members of the community. At first blush it does seem that as the debt is mainly held by the income tax paying class, and as the indirect taxes of those who do not pay the income tax also contribute to the debt interest, there is a transfer from the poorer to the richer. Moreover, as debt holdings of these payers increase more progressively according to their wealth than their total liability to taxes, the payment of debt interest might be said to involve a transfer from the poorer to the richer within the income tax paying class itself. It has been shown that the total amount

contributed to all services by the income tax paying class in Great Britain exceeded since 1932 the amount required for the services of the debt. It must also be remembered that in the case of other Government expenditure, notably the social services, there is a considerable transfer from the richer to the poorer. Before we come to a conclusion as to the harmfulness or the reverse of the transfer, it is necessary to examine all items of Government expenditure and the character of the taxes which are levied. By loans the burden of war expenditure has been distributed over a larger section of the community over a longer period than otherwise would have been possible. The immediate effect of heavy war taxation is to diminish the inequality of wealth, and it is probably this fact which makes socialists contend that the payment of debt interest involves a transfer of wealth from the poorer classes to the richer and, on the assumption that the holders of War Loan are the less active members of the community, a transfer from the active to the passive members of society.

Sir Walter Layton placed before the Colwyn Committee on National Debt and Taxation interesting data regarding the distribution of the National Debt. The figures were published in the Committee's Report,¹ and they show that not less than 36 per cent is held by private persons liable to Estate Duty. In this group are private individuals, including owners of private businesses and also the relatively well-to-do in industry. Joint-stock companies, trade unions, trust companies and foreigners hold 25 per cent. Banks and the monetary system of the country hold 16 per cent, savings banks 7 per cent, and insurance companies over 5 per cent. From these figures, which refer to nine-tenths of the Public Debt, the Committee concludes that the distribution of debt interest is propitious to national saving, since much of it is placed at the disposal of industry through the groups mentioned above. The Committee also doubts the theory that the distribution is from the more active to the more passive members of the community if Sir Walter Layton's analysis is to be accepted as regards the true distribution of debt holdings. "The average activity of the debt-holder would hardly appear to be less than normal. Evidently a great many of the holders, individual and corporate, are extremely active. It might be suggested, however, that the growth of the debt has had some

¹ Cmd. 2800, 1927, para. 263.

influence in increasing the number of rentiers and the amount they draw from the community. We doubt whether this is so. There were, of course, special opportunities for making large profits during the War, and this has no doubt led to the creation of a new class of rentiers. On the other hand, the change in the value of money hit the old class of rentiers very hard. Again, the heavy taxation has certainly not conduced to an increase in their number.”¹

In order to gauge exactly the effect of the transfer from tax-payers to interest receivers it would be necessary to know who are the interest receivers and who are the tax-payers, and what use each of these would have made of the money paid out by them or paid to them. Information would be necessary as to the cost of collecting the taxes which require the services of a large number of officials and non-officials, such as expert accountants, in the collection of the tax. Obviously all this is not available. Care, too, has to be taken to realise that the transfer of income from the taxpayer to the interest receiver is not regarded as the full measure of the way in which the system of borrowing first and taxing afterwards has affected the distribution of wealth in the community. There is a tendency to regard this transfer as an isolated transaction to the exclusion of everything else.

The following table is interesting as an attempt to measure the burden of public debt at different periods :

VII—THE BURDEN OF DEBT IN GREAT BRITAIN²

	1818.	1913 (Pre-War Year).	1923.	1933
1. National income . . .	£M 400	£M 2,300	£M 3,800	£M 3,500
2. National Debt . . .	840	650	7,700	7,860
3. Internal Debt Service				
(i) Interest and Management	31.28	16.94	271.45	262.31
(ii) Debt Repayment . . .	1.22	7.56	28.54	26.33
4. Ratio to National Income of	%	%	%	%
(a) National Debt . . .	210	28.26	202.63	224.57
(b) Internal Debt Service				
(i) Interest . . .	7.82	0.74	7.14	7.49
(ii) Debt Repayment . .	0.3	0.33	0.75	0.75
(c) External Debt Service . . .	..	..	1.24	0.57

¹ *Op. cit.* para. 273.

² *Vide Cmd. 2800, 1927, para. 676.*

It might be applied to other countries or as in the present case to a country at various dates in order to estimate the burden of debt. The general conclusion to be drawn from the table is that the burden after the Great War is not very different from what it was in the post-War period after 1815. The service of debt in 1818 was 55 per cent of the total expenditure, 14 per cent in 1913, the year before the War, 47 per cent in 1923, and 29 per cent in 1933. In 1818 the saving power of the wealthy was hardly touched by taxation, while after the Great War considerable limitations were placed on it. Real income has increased very considerably over the last century, and taxation provides to a very large extent for the social services, many of which were not in existence after the Napoleonic Wars. The burden of public debt to-day will be lightened by an expansion in productivity and by reductions through conversions in the rate of interest. The future burden is bound up with the uncertainties of the future rate of interest and the general level of prices.

In discussions on the burden of the public debt the question sometimes arises whether public debt should be included in the valuation of national wealth. There are some who include it and others who exclude it in an estimate of a country's wealth. We do not go as far as Dietzel in his remarkable book,¹ which had such an influence on German thought during the latter part of the nineteenth century, on public credit, when he maintained that a State's governmental functions were as productive as the manufacture of goods, and that the fixed capital necessary for them should be supplied by borrowing as legitimately as in the field of industry. The State, in his view, was the immaterial capital of a nation. Giffen in his *Growth of Capital* estimated the wealth of Great Britain by capitalising the income given in the income tax statistics and by supplementing the results where necessary by other estimates. He preferred to omit the National Debt from his calculations, although the British Treasury included it because it was personal property for the purposes of taxation. He himself said that he would not censure any one who included the debt as a part of the capital of the community, since the money expression of all the other capital of the community is less than it would otherwise be by the amount of the debt. If there were no debt

¹ *Das System der Staatsanleihen im Zusammenhang der Volkswirtschaft betrachtet* (Heidelberg, 1855).

lands, houses etc., would exchange "for rather more than they now do. The debt in this view represents a certain distribution of part of the capital of the country, and we do not get a complete view of the capital unless we include it."¹ Stamp, on the other hand, points out "that the effect of a long-standing debt like the public debts of most countries to-day would be, if existent at all, in the direction of depressed values, but certainly not *pro tanto* with the debt involved. It is, therefore, duplicating values almost to the entire extent to add Consols to the full fee simple value of national property."² Consols are a mortgage upon earned income as well as upon unearned income; both are subject to tax in order to pay interest on the public debt, and public debt is certainly property to the holders. He would reduce the valuation of the real property by the proportion of Consols secured thereon instead of by the whole amount of the debt. The problem is not so simple as it looks. The security of the public debt in the last resort is the taxpayers themselves who pay the interest and the amortisation of the unproductive debt by taxation and very rarely by a capital levy. They have subscribed to the loans, and if these are unproductive Government have spent them without having any revenue-producing fund to pay the interest on them. In the case of productive debt, such as are four-fifths of the public debt of India, it would be duplication were the value of the debt to be added to the value of the railways and irrigation works on which these productive loans were spent. There has been no fall in regard to public property where the debt is productive debt. Where the debt is unproductive the existence of securities in general causes a fall in the valuation of those other items of the national wealth the income of which is diminished by taxes consequent on the payment of interest on the public debt. Reduction of income to pay for the interest on the National Debt is not the equivalent of reduction of capital valuation, because the tax is distributed on all sources of income in such a way that capital does not shift within the country or abroad to any extent. The inclusion of public debt, of the character usually met with to-day, in the national wealth should, therefore, only be to the extent of the total or partial fall of the capital valuation of other sources of income owing to the taxation levied to pay the interest

¹ *Growth of Capital*, p. 22.

² *British Incomes and Property*, ch. xi. (London, King & Sons, 1922).

on the unproductive National Debt and only on that part of the National Debt the payment of interest on which is a burden upon unearned income or what is sometimes called the capitalisable section of the national income. Earned income will, therefore, have to be excluded.¹

¹ Cf. *La Inclusione del Debito Pubblico Nelle Valutazioni della Ricchezza delle Nazioni*. Luigi Einaudi, La Haye, 1934.

CHAPTER XXXIV

POLITICAL DEBTS AND REPARATIONS

THE NATURE OF INTER-GOVERNMENTAL DEBTS

1. POLITICAL, War, or inter-governmental debts were stated in Chapter XXXII. to require special discussion. They necessitate isolated treatment because they are a very special form of loan—a loan from one Government to another, usually with an implied advantage to the lending country. A common war effort and the prevention of financial collapse on the part of a State in which the lending State is interested are the most common causes of such inter-governmental debts. A second feature of political debts is that these external loans are almost, without exception, unproductive debts and, therefore, do not create their own means of payment. The heavy burden of such debts has been explained in the previous chapter. They are in marked contrast with commercial loans, which are normally self-liquidating and enable the borrower to repay the loans and at the same time to become more prosperous. War debts, in short, leave behind them nothing but complications and international ill will. A third point of difference is that since these debt payments have to be made abroad, their transfer across the exchanges has an important effect on trade and prices. It must not be forgotten that the total inter-Allied and relief loans are large; the indebtedness of foreign Governments, eighteen in number, to the United States on 1st October 1934 was \$12,098 millions (£2420 millions), of which the principal unpaid alone amounted to \$11,434 millions (£2287 millions). Of this amount the total debt owed by Great Britain was \$4714 millions, that of France \$3981 millions, and of Italy \$2010 millions. Seventy-five per cent of the American loans were made from 24th April 1917 to 15th November 1918, and the remainder (25 per cent) between 16th November 1918

and 1st November 1920. The total War advances by the United States to Great Britain were \$4277 millions (£855,400,000), and in respect of this the sum of \$2025 millions (£405 millions) was repaid as interest and principal to the United States. The following table gives the total inter-governmental debts in millions of dollars at the end of 1924 at the rate of exchange on the last day of that year:

INTER-GOVERNMENTAL DEBTS AT THE END OF 1924

(In millions of dollars at the rate of exchange on 31st December 1924)

Debtor Governments	Total Debt	To whom owed		
		United States	Great Britain	France
Great Britain . . .	4,554	4,554	..	..
British Empire other than Great Britain & Canada*	622	..	622	..
France . . .	6,911	4,138	2,767†	..
Italy . . .	4,755	2,097	2,639†	19
Belgium . . .	579	472	43	58
Russia . . .	3,872	252	3,267†	353
Poland . . .	254	179	23	49
Czechoslovakia . . .	155	116	2	29
Portugal . . .	104	..	104	..
Jugoslavia . . .	308	64	149	94
Rumania . . .	268	45	134	62
Austria . . .	113	30	51	18
Greece . . .	154	17	99	30
Estonia . . .	18	17	1	..
Armenia . . .	20	15	5	..
Belgian Congo . . .	17	..	17	..
Finland . . .	9	9	..	..
Lithuania . . .	6	6	..	..
Latvia . . .	6	6	..	..
Hungary . . .	2	2	..	..
Grand Total . . .	22,727	12,019	9,923	712

Source. National Industrial Conference Board, *The Inter-Ally Debts and the United States* (New York, 1925), p. 25. Cf. *Encyclopaedia of the Social Sciences*, vol 9, p. 558.

* The total debt shown in column 2 does not agree with the totals of columns 3, 4, and 5 in the case of all countries since Canada and Italy as creditor countries are omitted. France owed Canada \$6 millions, Belgium \$6 millions, Rumania \$20 millions, and Greece \$8 millions, or Canada was a creditor to the extent of \$40 millions. Italy was a creditor country of Poland \$3 millions, Czechoslovakia \$8 millions, Jugoslavia \$1 million, Rumania \$7 millions, and Austria \$14 millions, or a total of \$33 millions. If these totals are included the distribution of the debt totals \$22,727 millions.

† Net.

The total debts owed to Great Britain by its Allies on 31st March 1933 were £1166 millions, of which £756 millions were owed by France and £253 millions by Italy. Great Britain received no receipts against its advances, and in addition

made large payments out of its own resources to the United States on account of its War debt obligations. The British payments have been made possible by unprecedented taxation, the burden of which since the War amounts to one quarter of the whole national income and exceeds—for a considerable period it was double—the total burden of all federal state and local taxation in the United States. In 1931 further increases of taxation were imposed together with retrenchment and economy in public expenditure, and in the following year a conversion of £2087 millions of public debt made it possible to avoid a deficit in the following year. It would have been, as the British Government pointed out, a gross act of social injustice to the taxpayers if, in order to pay War debts to the United States, they had been denied relief from the emergency sacrifices imposed in 1931 while Great Britain received nothing in the form of War debt payments due to it.

Inter-governmental debts are not a question of internal revenue except in so far as the debts are paid for by internal revenue which has to be converted into the creditor's currency or into gold. They are payments which have to be related to the balance of trade. The debt owed to the United States by Great Britain is less than one-half of the total of the debts owed to Great Britain by her debtors. If the ten principal debtor nations to the United States paid the interest and the principal on these debts over the entire currency of the loans, the aggregate total payments would be no less than £3000 millions. It is clear, therefore, that the payment of these large amounts would necessitate a complete change in the economy of the debtor and the creditor countries alike. This fact was realised and no attempt was made to collect the debts until from 1923 to 1925 the United States called on the debtor countries to fund their agreements. The conclusion accordingly is that Great Britain would have received annually, if paid its interest on War debts and reparations (which in the absence of the Lausanne agreement made by Great Britain, France, Italy, Belgium, and Germany, would have been due on 8th July 1932), £64 millions, and would have had to pay to the United States £51 millions. Thus the debts owed to her would have exceeded those owed by her to the United States.

Political loans in peace time are, as a rule, small in amount

and do not have the repercussions of large war loans. They are usually for financial reconstruction in some form or other, as, for example, those made to Austria in 1923, Hungary in 1924, Greece in 1924–27, Bulgaria in 1926 and 1928, Danzig in 1925 and 1927, and Estonia in 1927. The danger of this kind of loan is that they may place the debtor state in a position of subordination to the creditor. It is on this account that sometimes the national loans are guaranteed by several states. In 1923, for example, Austria obtained a loan of 585 million gold crowns, Great Britain, France, Italy, Czechoslovakia, Belgium, Sweden, Denmark, and the Netherlands each guaranteeing a fraction of the loan. The service of the loan was secured by appropriating substantial sources of revenue under the control of the League of Nations. In connection with League loans a definite procedure is followed and the League gives it its moral support after inquiry by a recommendation to bankers. The rights of the creditor are protected by a Foreign Commission, and there is usually a more or less strict control over the finances of the borrowing state by a representative of the League.

The fundamental difference between War debts and commercial debts and the size of these are the main grounds, in short, for separate treatment. War debts produce also peculiar political, economic, and financial difficulties. History shows that there is also opposition on the part of the countries to the payment of these loans, as it is urged that the proceeds of war have been spent in a common aim and some of the debtors have made greater physical sacrifices than the creditor or creditors. As years go on, this political argument tends to become stronger and stronger, because new generations who knew not of the War object to the heavy burden laid on them. Thus the British Prime Minister, the Earl of Liverpool, in March 1816 was attacked by the critics of the Government for his “expensive and disinterested generosity” in regard to the debts owed to it from the Allies. Lord Holland asked whether Great Britain was to have no relief “while the other countries which they had rescued by their blood and treasure were not even to pay their just debts, because, forsooth, they were unwilling, or said they were unable, though their resources had so greatly increased”. The House of Commons was not enthusiastic when the debt with Austria was settled in 1823. Members said in 1824 that “in justice to other

bankrupts the Emperor's name ought to appear alongside theirs in the *Gazette*", and that "2s. 6d. in the pound was not a handsome composition for an Empire". History repeated itself during the period 1923 to 1933. The views of continental Europe were well summarised by M. Louis Marin when he asked in the French Senate on 22nd January 1925, "Are lives and limbs lost on the battlefield of less value than money loaned? Are the terms of the Peace Treaty insisted on by America and never ratified not worth some compensation? While war still raged, statesmen in every country appealed in the common cause, some countries gave their ships, some munitions, some the lives of their sons, some money, and to-day only those who gave money come, saying to us, 'Give back what we loaned'." In short, the money was borrowed not to use in business in the ordinary way, but in order to fight a battle which was as much America's as it was Europe's. As America's men were not ready, America supplied the materials. No credit, however, was given for men supplied to the common cause, but full credit was given for materials such as cotton, munitions, cereals, and other foods, and at prices three or four times their normal price. On the other hand, the creditor country or countries are apt to regard the loan as a purely commercial loan, to overlook the transfer problem in money payments, and to forget the effect of payments in kind on the receiving or creditor countries. Thus in 1934 the United States demanded the payment of War debts on the ground that the question had "gravely complicated our trade and financial relations with the borrowing nations for some years", and the President recalled that "the money by the United States was in turn borrowed by the United States Government from the people, and that our Government, in the absence of payments from foreign Governments, has been compelled to make up the shortage by general taxation of its own people". "The American people", he said, "would not be disposed to place an impossible burden on their debtors, but are nevertheless in a just position to ask that substantial sacrifices be made to meet these debts."

Next with regard to economic and financial consequences. In recent years two mutually opposite policies have been followed. On the one hand, an international financial system has been developed which involves the annual payment of large sums by

debtor to creditor countries. On the other hand, obstacles have at the same time been placed in the way of the free movement of goods and services so that capital cannot move except in such a way as to upset the world's financial equilibrium. Creditor countries have refused to accept payment in goods and services, and this has compelled their debtors to pay in gold. Gold reserves, therefore, in debtor countries have been drained, if not exhausted. This in turn has depressed the price of commodities in terms of gold currencies. This fall in prices has brought widespread ruin to producers in creditor and debtor countries alike, because the whole world to-day is closely linked up in economic solidarity. The fall in prices has seriously increased the burden of commercial debts and at the same time has made intolerable the peculiar burden of War debts. These facts are a plain tale which must be told in plain language, and they show that it is impossible to exchange sums of the required magnitude of War debts from one currency to another without disastrous effects on trade and prices. It is sometimes overlooked how these payments to the United States throw the whole international financial machinery out of gear. The War changed America from a debtor into a creditor country in too short a space of time. In post-War years this was intensified by the very unnatural combination of large exports and high protection against imports. This unnatural process was accompanied by a demand for payments on War debts and also by excessive foreign lending. It would not be wrong to regard these developments since the War as the main causes of the great trade depression of 1929-34. The world, therefore, had to base itself on borrowing from the United States in place of selling to that country. Foreign lending indeed on the part of the United States was encouraged by the extreme poverty in Europe. In ten years the United States lent abroad as much as the net foreign loans of Great Britain during the whole of the nineteenth century. This lending was certainly brought to an end by the growth of the American boom in 1929, which led to a cessation of America's international lending to which the world had become accustomed. The United States' export surplus before 1915 varied from \$200 millions to \$600 millions. In 1917 and 1918 it exceeded \$3000 millions and in 1919 was about \$4000 millions. War loans were made to meet the requirements of the belligerents and took the form of muni-

tions and food. The debtor countries were credited at extravagant prices for those goods required in the prosecution of the War. It was no one's fault, because it arose from the difficult conditions of the time. These, however, being taken in the form of goods enormously increased the volume of exports in lending countries. The United States, in brief, refused to take payment in goods and services and demanded gold. So long as debtor nations are compelled by every means to increase their export surpluses in order to meet inter-governmental debt burdens they cannot play their part in normal commerce. Their purchasing power is diminished, and this is reflected in diminishing receipts in the hands of producers in the creditor country. The United States has still a large favourable balance of payments and will not lend abroad. The result is obvious. It is exercising a deflationary pressure on the world, and will continue to do so until its exports decrease or imports increase or its foreign debtors default. Equilibrium will not be restored until then. The payment of the debt implies that the creditor will be willing to accept goods and services sufficient to cover the debts due to it over and above the goods and services required to cover its exports, and this means a complete reversal of the existing favourable balance of trade between the United States and the rest of the world. This raises a wider issue of inter-governmental obligations resulting from the World War. The British Government in their Note,¹ dated 4th June 1934, referred to the possible payment of debts in goods, and the United States Government in its reply said that "No proposal had ever been presented to the Government towards payments in kind to an extent that might be found mutually practicable and agreeable". The President, in view of the criticisms raised with reference to payments in kind, stated that this simply meant a declaration of the Administration's willingness to discuss with the British Government a matter which the latter had themselves raised in their Note, and he emphasised that payments in kind could be "very partial" and the debt could "obviously not be discharged in whole" by such means. He declared that the United States Government had no intention of permitting American industry or agriculture to suffer as a

¹ Papers relating to the British War Debts, Cmd. 4609, 1934. Cf. Cmd. 1912, 1923, Cmd. 4202, 1932, Cmd. 4210, 1932, Cmd. 4211, 1932, and Cmd. 4448, 1933.

result of any debt agreement embodying such payments. There the matter has remained since June 1934, and it is clear that international transfers such as would be necessary to transfer such enormous sums would be impossible without radical alteration in the economic policies of the United States. Indeed it was this very point that Jefferson, the Secretary of State, in a long and able Memorandum to the British Government signed by George Washington and Alexander Hamilton, stressed regarding the payment of debts amounting to \$11 millions that were owed to British merchants. It was impossible to pay large sums of debt in gold or silver, he said, since America had lost its stocks owing to the war, and that he held that there was no moral reason for fulfilling the debt clauses of the Treaty of Peace 1783, since the British Government had, by its fiscal policy and shipping policy, lessened America's means of payment. These debts, it may be noted, remained outstanding for very many years, until in 1802 it was decided to discharge them by a payment of \$2,664,000 in three annual instalments. Payments in kind referred to in June 1934 marked the largest intellectual advance yet made upon the subject of War debts by an American Administration. Payment in such a form may overcome the specific transfer problem involved in money payments. But it was the history of payments in kind by Germany that aroused intense opposition in the countries at the receiving end. The American producer and trader now have to ask the question, "Do we want to be paid?" This will become in the future a main issue of the United States in regard to War debts.

WAR LOANS VERSUS SUBSIDIES

2. The first instance in modern history of a direct inter-governmental loan is the case of France, which advanced to the United States during the War of Independence loans extending over the period 1777 to 1783. These loans amounted only to \$6,352,500, and of this amount \$4,327,600 were repaid in 1795. The balance (\$2,024,900) was converted into domestic loans bearing interest at $4\frac{1}{2}$ per cent and $5\frac{1}{2}$ per cent per annum. These loans were repaid—the $4\frac{1}{2}$ per cent between 1807 and 1808, while the payment on the $5\frac{1}{2}$ per cent was finally made in 1815. These loans, however, were very small as compared with the enormous twentieth-century

War loans. Apart altogether from their size there is another great point of difference. The creditor State was not in the same position to France as she was in the Great War when the issue was as much America's as it was of her other Allies, who were in the trenches in France long before she was able to come into the War. General Pershing, the commander of the American forces in France, said that if it had not been for the Allies, "who held the line fifteen months after we entered, it might well have been lost", and "We were responsible for their having to hold the line, and we advanced the money which made it possible for them to hold it. But I believe part of that expense should now be borne by the United States."

Great Britain in 1795 and 1797 gave loans to the Emperor of Austria amounting to £6,200,000. Portugal also received a loan in 1809 which was remitted by the Treaty of Vienna in 1815. In 1855 Great Britain gave to Sardinia a loan of £2 millions to equip an army of 15,000 men against Russia in the Crimean War. The policy of Great Britain, however, has always been subsidies rather than war loans. Subsidies as a phase of war effort can be traced even to the time of Edward III in his alliances with German Princes and the Emperor Lewis the Bavarian.¹ Walpole began a regular system of advances in 1741 when £300,000 were advanced to Maria Theresa, and this subsidy was increased by Carteret to £1,250,000. It was found cheaper and more satisfactory to grant subsidies than to send soldiers abroad, especially as British troops were more expensive to maintain than continental. In the Seven Years' War Pitt helped Frederick with subsidies against the French, as Pitt wished to conquer Canada in Germany. In the last decade of the century from 1793 Great Britain financed her allies by subsidies, and between 1793 and 1816, out of a total of £57 millions in loans and subsidies to foreign states, over £50 millions alone were in subsidies.² An American historian, Professor Edwin F. Gay of Harvard University, in a paper on "War Loans or Subsidies", points out that in regard to the American War Debt it is difficult to find any evidence in the historical record that the policy of

¹ Cf. "War Loans versus Subsidies" (*Foreign Affairs*, New York, vol. ix. No. 4, 1931).

² *Accounts relating to the Public Income and Expenditure of Great Britain and Ireland* (2 vols., 366 and 366—I—1869), vol. ii. p. 681. Both volumes are indispensable to the student of British finance.

subsidies was given any serious consideration ; but that after the experience of the Austrian loan the British policy was not to engage in any transactions of that kind but to follow the traditional system of subsidies. "The fact remains", says Gay, "that subsidies, not loans, had been adopted by England as a settled policy, that while her Allies shed blood in the common effort, she furnished her share of the treasure. At the end of the struggle, for all practical purposes, England wiped the slate clean. Beset with difficulties of the gravest character at home, with taxes at an unprecedented height, with such serious financial complications that Ricardo was supporting a demand for a capital levy, with agriculture in distress and industry languishing, with an army of unemployed, and with riots in her manufacturing towns, England, nevertheless, showed expedient moderation toward France and prudent forbearance toward her Allies. She left the Continent unhampered to undertake its necessary economic reorganisation. Her action was not quixotic ; it was not merely the 'gentlemanly tradition' of government. The 'new doctrine of disinterestedness' with which Lord Liverpool was taunted, was calm and far-sighted statesmanship." Gay concludes that the future American historian may be forgiven if he repeats sententiously the sound lesson of Lord Liverpool's prudence and expedience. "In case of war, if you can give at all, give and do not lend."

War debts in the Great War began in October 1914 when Russia applied to Great Britain for financial assistance. In the following year Great Britain, France, and Russia pooled their military and financial resources. A credit was opened in London in 1915 for 1500 million francs on behalf of France, and France sent to the Bank of England gold in the same year which was to be returned after the War when the credits were repaid. Great Britain and France gave loans to Belgium, Russia, Italy, Serbia, Rumania, Greece, and other countries. When France became exhausted, Great Britain alone made loans until 1917, when the United States entered the War and became the chief creditor of the Allies. The loans were expended in the United States for the purpose of winning the War.¹ The United States first

¹ Cf. The authoritative review by the Assistant Secretary of the American Treasury in charge of Foreign Loans from 1918 to 1920—Albert Rathbone, "Making War Loans to the Allies" (*New York, Foreign Affairs*, vol. iii. April 1925).

lent to England which distributed the amounts among the Allies, but later the United States herself lent directly to various Allies. After the War the United States continued to lend for the economic rehabilitation of Europe. In 1922 an Act was passed by the American Congress setting up the Funding Debt Commission.¹ It reaffirmed unconditional payment of interest and principal and made a series of agreements between 1923 and 1925 with its debtors. It provided for the refunding of the Allied debts by the issue of securities which were to mature in twenty-five years and carry a rate of interest not less than $4\frac{1}{4}$ per cent, the rate paid by the United States Government on its internal loans. The Agreements made by the Funding Debt Commission specify the repayment of the principal, although they do not keep to the rate of interest or to the period of repayment. The rate of interest varies with the "capacity to pay", and repayment is distributed over sixty-two years. Great Britain and France also concluded funding agreements with their debtors, but Great Britain laid it down that in no circumstances would she collect more than the equivalent required to pay the United States. The Balfour Note of August 1922, therefore, definitely linked up War debts with reparations. Great Britain bound herself unilaterally and this premature move hampered her in later negotiations. It would have been more expedient to wait, and it might then have been clear whether this would have been accepted by others. The Dawes Commission of 1924 reduced reparations from the astronomical figure which hitherto had held the field. These indemnities continued to be paid as there was a large flow of investment from the United States into continental Europe. The prosperity, however, between 1923 and 1929 contained the germs of future trouble. The debtor countries as they could not pay in goods and services were forced to pay in gold, and matters got from bad to worse. In the summer of 1929 the Young Plan was framed and Germany promised to pay annually an equivalent of \$500 millions or £100 millions at par, the major part of which was to be passed on as War payments to the United States. With the collapse of 1931, European creditors did not and could not pay. The Moratorium, which

¹ The Commission, after the conclusion of debt agreements with all except five debtor nations, ceased to exist on 9th February 1927. The Funding Agreements covered more than 97 per cent of the total principal of obligations outstanding when the Commission was created.

was the result of President Hoover's initiative, began from 1st July 1931 and suspended inter-governmental payments for the Hoover year—1st July 1931 to 30th July 1932. The object of the Hoover Moratorium was "to relieve the pressure of the difficulties resulting from the fall in prices and lack of confidence in economic and political stability, and to assist in the re-establishment of confidence, thus forwarding political peace and economic stability in the world". With the cognizance and approval of the United States Government, the creditor Governments of Germany, *i.e.* the representatives of Great Britain, France, Italy, and Belgium, met at Lausanne, and an agreement was signed and payments in respect of War debts of France, Italy, and other countries were suspended, except in the case of Great Britain to the United States, which continued up to December 1933.

In their Note of 1st December 1932 the British Government stated fully why the system of inter-governmental debt obligations, as it existed before the Hoover Moratorium, could not be revived and why a radical revision of the existing settlement was essential. Only an instalment of the British debt due on 15th December 1932 was paid, and paid in gold mainly because the American Government had stated that such a payment, in their opinion, would increase the prospect of a satisfactory approach to the whole problem of War debts. The British Government stated that this payment was not to be regarded as a remission of the annual payments under the existing agreement. Discussions took place in the spring and autumn of 1933, but no settlement was arrived at. On 15th June and 15th December 1933 the British Government made token payments, and the President of the United States expressed his personal view that he would not regard this as a default. In June 1934 the Government would have been prepared to make a further payment in acknowledgment of the debt and without prejudice to their right of again presenting their case, provided that the President did not consider this a default. Legislation in the United States, however, made this impossible, and therefore the Government decided to suspend all inter-governmental payments pending a final revision, since the regular remission of full payments to the United States would revive the whole system of inter-governmental War-debt payments and postpone indefinitely the chances of world recovery.

There was, as was stated at the time, no intention of repudiation of obligations. Discussions would have to wait until, in the opinion of the President of the United States, such discussion would be likely to be of value.

The Funding Debt Commission have stated that capacity to pay does not mean requiring the foreign debtor to pay to the full limit of its present or future capacity. "It must be permitted to preserve and improve its economic position, to bring its budget into balance, and to place its finances and currency on a sound basis, and to maintain and, if possible, to improve the standard of living of its citizens. No settlement which is oppressive and retards recovery and development of the foreign debtor is to the best interest of the United States or of Europe." The principle of the capacity to pay, however, in post-War inter-governmental loans is of secondary importance to the capacity of the world to endure the consequences which these huge transfers involve.

In no circumstances should the world disorder be perpetuated that reactions are set up involving losses many times greater than the total amount of War debt. Fourteen other States suspended the bi-annual payments to the United States in June 1934. Thus the effective collapse of the whole structure of debt-funding agreements, initiated between 1923 and 1925, took place with dramatic suddenness and among the debtors unanimously. The question of War debts was indeed removed from the land of sentimental make-believe to the firmer ground of economic realities. The suspension of payments without any possibility of their being resumed in the old form will tend to result in the whole debt question slipping out of the international political foreground, and much of the irritation which has been injected into international relations will ultimately disappear. Cancellation is the best policy. If the debtor should have the ability to pay, it is unwise for the creditor (in his own interest) to ask the debtor to pay, as the payment will interfere with the creditor's prosperity. If cancellation is not possible, a reasonable single-debt payment in full settlement is, *faute de mieux*, the alternative. In view, however, of the attitude of continental countries to War debts and of the *de facto* connection between the two sets of inter-governmental obligations, the latter is less likely than the former.

WAR INDEMNITIES AND REPARATIONS

3. A distinction is sometimes drawn between war indemnities and reparation or reparations. The latter term arose at the Peace Conference after the Great War and was a deliberate creation to emphasise the idea of making good the actual damage done in the War, and at the same time to avoid the idea of indemnity to meet the cost of the War or profit to the victors. It was, therefore, used to describe the payments to repair damage, in cash and in kind, demanded by the Allies from the Central Powers, mainly, if not entirely from Germany. The demands were based on the restitution of physical objects which had been destroyed and also on the compensation due to civilians for direct injury. The Peace Conference was dominated by a war psychology and a lust for vengeance. It was only after a struggle that direct war costs were excluded. In spite of the strong protest of Germany, the capitalised value of separation allowances and war pensions were included. From the history of the negotiations on reparations spread over fourteen long weary years the cupidity and the selfishness of politicians stands out clear as the noonday, and one sees the truth of the saying that when politics comes in at the door economic and financial principles fly out at the window. The real effects, for example, of the physical transfer of goods from one country to another, from the national heap of goods and services produced in one country to that in another, and the importance of fixing indemnities or reparations according to capacity to pay, were forgotten in the haste to extract from the defeated enemy excessive sums in order to balance budgets or to pay for reconstruction. Before the Dawes Committee was convened in 1923, the elementary truth was overlooked to an incredible degree that a country, after paying by direct means all that it can, such as immediately transferable wealth in the form of gold, foreign securities, ships, and property in ceded territory, must fall back on paying by the goods and services which it produces. Notwithstanding this simple truth, we find a long-drawn-out struggle on the part of the creditors to forget it and to prevent the debtors from paying by goods and services. The difficulty lies in the fact that both the principal creditors and the debtor were highly industrialised countries producing the same goods, and when the debtor paid the creditors in these, the creditors found that the

home market for their own producers of these goods was *pro tanto* reduced. They were, too, placing themselves at a disadvantage with their customers in neutral countries, who were unwilling to purchase from the creditor country when the reparation-paying country was dumping cheap goods into it. On the other hand, until 1923 a large part of German deliveries in kind went to Yugoslavia, an agricultural country which could absorb these without disadvantage to itself. In other words, the paying country should be the complement and not the rival of her creditors—she should be an industrial country if her creditor is an agricultural, and if her creditor is industrial she should be in the main agricultural. The only way in which reparations can be satisfactorily paid is if the payer is a producer of different goods. The absence of this principle accounts for the high tariffs and deflation which have had so restrictive an effect on the possibility of reparations on any large scale.

Reparations are closely connected with War debts, although from the purely legal viewpoint this may not be so. At the infructuous Hythe Conference, 1920, where reparations and Germany's taxable capacity were discussed, it was proposed to link up War debts with reparations. The connection between the two was the basis of the Balfour Note of 1922. In the Young Plan, 1929, the connection was again emphasised, as European nations held that reparations from Germany should be as nearly as possible the equivalent of the War debts to the United States. The matching of debts with reparations was a step forward in the Young Plan, where the provision of varying the amount of reparations with the change in the value of gold was dropped, although this had been a feature of the Dawes Report, 1924. No such variations existed in the War debt funding agreements. The United States Government admitted by implication the connection between the two sets of inter-governmental obligations when the Hoover Moratorium was proposed in 1931. The Lausanne Agreement, 1932, also took note of this connection. The agreement was not to be ratified until the creditors of reparations had made satisfactory settlements with the United States on War debts. Reparations and War debts are War obligations and are clearly inseparable; they are part of the aftermath of war; are entirely different from productive debts and are, therefore, a burden on the debtor

State, since they tend to reduce in the paying country the standard of living, purchasing power, and savings out of which internal capital comes. They are both inter-governmental obligations.

The history of the nineteenth and twentieth centuries makes it possible to draw certain conclusions in regard to indemnities and reparations. There are five classic examples of indemnities in this period, viz. the Treaty of Tilsit, 1807, the second Treaty of Paris, 1815, the Treaty of Frankfort, 1871, the Treaty of Shimonoseki, 1895, and the Treaty of Versailles, 1919. By the first of these treaties, Napoleon forced an indemnity which was far beyond the capacity of Prussia to pay, Prussia being then predominantly agricultural and without any large industries or foreign trade. The total indemnity was estimated at £26 millions. By a convention supplementing the Treaty he maintained 100,000 men in Prussia at its own expense until the indemnity was paid—a practice which, it is interesting to note, has been followed subsequently. In the second Treaty of Paris, 1815, an indemnity of 700 million francs was imposed, and in addition 150,000 men were kept by the Allies for five years in the main defences of France, costing 250 million francs a year. In 1871 France was compelled by Germany to support a German army in northern and eastern France until an indemnity of 5000 million francs (£200 millions) was paid. To the surprise of the world France paid this off in two years and four months. To meet this the French Government floated two large loans to the equivalent of £230 millions. With the proceeds of the loans the Government was able to purchase through the Bank of France in France itself 750 million francs worth of German banknotes and 1500 million francs of securities with an international market. The remaining sum, 2750 million francs, was obtained through the purchase of bills of exchange. The German banknotes were, of course, German money left in France. It is not possible to say how much was used from past savings, although it has been estimated that 1500 million francs were from current savings or hoards. The increase in the public debt was permanent. No difficulty arose in regard to the transfer problem. The German banknotes were readily acceptable and the securities were sold without difficulty in Berlin. In regard to the bills of exchange, the goods were shipped out of France and the proceeds made

over to Germany. France, too, had a favourable balance of trade during this period, and Germany in 1871 was a free-trade country. It has been held that the payment of the indemnity did Germany more harm than good. The credit of the debtor country is upset by the indemnity, and this affects the creditor country and other countries, as nowadays the whole world is mutually inter-dependent. Moreover, tariffs and quotas are put into operation against the goods of the indemnity-paying country. Norman Angell¹ showed that Germany had to face a serious depression especially in the year 1876–77; French industry, on the other hand, it is argued, was stimulated by the payment of the indemnity. It is difficult to estimate how far France was better off than Germany as a result of the indemnity and how far the payment of the indemnity itself led to Germany's troubles, but it must be admitted that the indemnity gave Germany increased purchasing power and made it possible for Germany to reform its currency and also to increase its military power without putting a very heavy strain by taxation on the masses. The Treaty of Shimonoseki in 1895 brought an indemnity to Japan of nearly £36 millions, and it gave Japan foreign credits which, some hold, modernised her industry. It cannot, however, be said, all things considered, that the indemnity was the cause of the industrial advance of Japan in the present century any more than it was that of Germany in the last century. The articles 231 and 232 of the Treaty of Versailles, 1919, provided for reparation for the damage done and also for a Reparation Commission to assess the extent of the damage precisely on the various items laid down in the treaty. The treaty did not answer the question "What can Germany pay?" but only laid down the items on which her liability for reparation was to be based. It was left to the Reparation Commission to evaluate these items in the Peace Treaty, to make as it were the total of the sum set to them. Beyond that it could not be blamed for what followed. A series of conferences in various places at various times had already proved abortive, and in March 1921 the Allies decided to follow the basis of action provided for by the treaty (which came into being in January 1920). A Reparation Commission was

¹ Cf. Norman Angell, *The Great Illusion* (London, 1910), but see O'Farrell, *The Franco-German War Indemnity and its Economic Results* (Garton Foundation Study, London, 1913).

appointed on 27th April 1921 which assessed Germany's liability at 132,000 million gold marks, or £6600 millions. It may be noted that in this very month Germany offered to satisfy its reparations obligation by paying 50,000 million gold marks at its present value or annuities to the extent of 200,000 millions, an offer considerably above the amount later accepted under the Young Plan. The Reparations Commission in May notified the German Government of the schedule of payments. Three series of bonds to the total amount were to be issued by Germany—they were in fact never issued—and two sets of annuities were to provide the funds for the service of the bonds—one fixed at 2000 million gold marks and the other variable at 26 per cent of Germany's exports. Certain revenues, including customs, were to be assigned as additional security. Under the British Reparation (Recovery) Act of 1921 and under similar legislation in France, Germany was to pay its exporters for levies on imports into those countries made by the respective Governments on reparations account. This resulted in a serious crisis in Germany, but the terms were finally accepted. The first 1000 million marks were to be paid within twenty-five days. The mark began to depreciate in consequence of the efforts of the German Government to buy foreign exchange, and by the end of 1921 a partial moratorium had to be granted to prevent default. Conditions in 1922 were as bad as in the previous years and the mark continued its downward course. Finally, early in January 1923, the Reparations Commission again declared Germany in default, and French and Belgian troops two days after this default later moved into the Ruhr. The struggle in the Ruhr lasted from January to the end of September, when the Berlin Government, owing to the lack of success of a passive resistance campaign and the phenomenal depreciation of the mark, submitted and then negotiated with the Micum (La Mission Interalliée de Contrôle des Usines et des Mines), responsible for deliveries in kind. This period of reparations history will be a lasting monument of sheer incompetence on the part of the German authorities, especially in permitting the passive resistance to French occupation in the Ruhr to be financed by the printing press. The French franc in the meantime had depreciated by a quarter, and the recovery of all Western Europe was retarded by these events in the Ruhr and the uncertainty injected into international trade. There was conflict between the

Allies and Germany and, as is well known, between the Allies themselves. France stood by the letter of the treaty, while Great Britain attempted to face economic and political realities with a view to accelerate trade recovery at the earliest possible opportunity. Moreover, there was the further conflict on the one hand that Germany must make reparation payments, while on the other the Allies themselves were unwilling to receive the payments when it came to deliveries in kind. The creditors found that if the Germans were allowed to send goods such as coal and machinery this would reduce *pro tanto* the demand in their own markets.

It was now vital to take the whole matter out of the political arena, and the Reparation Commission announced on 30th November 1923 that two Committees of Experts were appointed—one to deal with German currency stabilisation and the budget and the other with German capital abroad. The Committee took its name from the Chairman, Mr. Charles G. Dawes. The Plan was really a British idea. It marked a great step towards the solution of the problem of obtaining reparations from a country totally denuded of working capital and completely exhausted by a war in the way that France was not in 1871. Germany was out of action and completely exhausted by the inflation following on the occupation of the Ruhr. Inflation had practically wiped out the entire liquid capital of Germany. The classic Dawes Report¹ got down to realities, and the Committee recognised that the first thing to do was to put Germany again on her feet if reparations were to be collected at all. It could not, owing to French susceptibilities, touch the total of reparations. It was, however, concerned with the budget, and unless the budget could be balanced reparations could not exist. Reparations, therefore, as an annual burden was treated with great care. The Committee distinguished between the tax burden on the one hand and the amount of export surplus which could be got out of Germany without upsetting the exchanges. The Committee proposed that the German Government should raise the requisite taxes to balance the budget on the lines of their Report. Having made sure of sufficient taxation, the creditors themselves could arrange the transfer of marks into the currency of other countries provided it did not interfere with the stability of the exchanges. This transfer side of the work was supervised

¹ Reports of the Expert Committees appointed by the Reparation Commission, Cmd. 2105, 1924.

by a Transfer Committee *in situ* in Berlin under a single authority. The Reichsbank was at the same time reorganised. An ascending scale of annual payments subject to a possible increase on an index of prosperity was arranged, as was security for the payments by an elastic control over assigned revenues. The annuities in 1924–25, therefore, began at 1000 million gold marks and rose to 2500 million marks in 1928–29; the total for the five years was 7970 million marks. An equivalent of 125 million marks a year was to be increased progressively as Germany's power to pay increased. The year 1928–29 was taken as the standard year, and thereafter the annuities were to fluctuate with changes in the value of gold of 10 per cent or more, and they were to increase with an index of prosperity. The bonds were secured on the railway system and on industry and gave rise to no difficulty. The burden on the federal budget was not heavy, amounting to less than 20 per cent of the whole in the standard year. As a result of the Dawes Plan accepted by Germany and her creditors at the London Conference in August 1924, Germany for five years was able almost to forget the problem of reparation and to devote itself to developing its resources. During this period Germany stabilised her finances, and by the end of 1928 had regained the general economic strength that prevailed in 1913. The Plan thus worked successfully, although the unwillingness of creditors to receive payments in goods continued to be serious. The real problem indeed was the ultimate importing power of the creditors. Fortunately for Germany, the surplus savings of America and elsewhere were finding an outlet in Germany; but the Agent-General of Reparations in Berlin and the President of the Reichsbank were always warning the world that Germany was borrowing too freely and was not investing the money in productive assets. But public opinion in Germany supported this misdirected and extravagant policy of borrowing, as reparations were never regarded as a moral obligation. It was always expected that sooner or later a way would be found to abolish or to evade them altogether. The history of reparations has been largely a question of lending back to Germany through the ordinary course of investment from abroad the amount which it has paid in reparations. This was essential at least for some years because Germany was so completely denuded of circulating capital. A considerable part of this inflow of foreign capital (46 per cent) was short-term capital, and much of this

foreign capital was not for productive purposes but was expended on municipal enterprises like housing schemes, public baths, playgrounds, and parks financed on a lavish scale. Industries, too, indulged in an uneconomic orgy of capital equipment on borrowed capital from abroad, especially from the United States, which supplied half Germany's long-term borrowings, half the total of acceptance credits, and about a quarter of the short-term credits between 1924 and 1931.

In 1929 the somewhat premature plan known as the Young Plan¹ came into being. It reduced the payments to a terminating series of fifty-nine annuities and thus fixed definitely the total amount of reparations. The annuities rose gradually to the year 1965–66, but began at only two-thirds of the Dawes standard annuity, and the average annuity was only 2000 million marks, or four-fifths of the Dawes standard annuity. The annuities before 1965–66 included part of the debt payment as well as reparations proper. But after 1965–66 the payments were to drop approximately to the debt payment. The annuities, too, were to be diminished if the United States reduced its claims on War debts. It was provided that limited transfer protection up to two years should be given to the larger fraction of each annuity, but 612 million marks a year could not be postponed, just as the service on the German external loan of 1924 amounting to 61,800,000 marks a year was non-postponable. The plan also carefully regulated deliveries in kind which hitherto had given so much trouble. Part of the annuity was payable unconditionally—the commercialised portion—and the other conditionally, *i.e.* it might be suspended for a period of years so that Germany may get some respite in any period of great depression of trade. It provided for the commercialisation of part of these payments and gave Germany the sole responsibility of the service of the loans. It also abolished the Dawes Plan machinery—the Agent-General, the Transfer Committee, and all political machinery in Berlin. In abolishing the Reparation Commission it provided for the establishment of the Bank for International Settlements at Basle to collect and disburse Germany's payments and to serve as a central international co-ordinating authority among the world's Central Banks. Unlike the Dawes Scheme, it was at the mercy of the changing

¹ Report of the Committee of Experts on Reparations, Cmd. 3343, 1929.

value of gold ; but this was thought advisable, since War debts, with which these were matched, had no such fluctuating basis. The weak points of the Scheme are : (1) that it did not fix the amount of reparations after an impartial and scientific study of the taxable capacity of Germany ; and (2) it made a change when economic conditions were far from stable. The Plan owed its existence to the fact that many statesmen believed a final settlement could be safely substituted for the transitional one and that a considerable portion of Germany's payments could be commercialised, thus enabling the creditors to get considerable capital sums at once in place of their existing right to variable annuities. Germany opposed this mainly because it meant a definite series of annuity payments without protection of the transfers and also the clauses permitting the value of gold in accordance with an index of prosperity. The annuities totalled 121,000 million marks (£5760 millions), and began at only two-thirds of the standard of the Dawes Plan annuity. The average 2000 million marks was only four-fifths of that size. The plan was short-lived, as the payments of the second year were suspended through the acceptance by the Allied Governments of the Moratorium proposed by President Hoover.

By the Lausanne Agreement, dated 8th July 1932, reparations were cancelled and Germany was to make an eventual payment to the equivalent of £150 millions by means of German Government Redeemable Bonds to the amount of 3000 million gold marks as from the year 1935. The bonds are deposited with the Bank for International Settlements and bear interest at 5 per cent and with 1 per cent amortisation, which will extinguish the bonds in thirty-seven years. The ratification of the Lausanne Agreement, it may be pointed out, will not take place until a settlement has been made with the United States on inter-Allied debts, and if such a settlement is not obtainable the creditors are to revert to the position existing before the Hoover Moratorium. The reparations system, which contributed so much to the economic confusion of Europe and the world, ceased to exist, and the spread of economic gangrene was stayed. Reparations are now practically a dead question. Payments from one country to another group of countries have been abolished, and Europe has decided to act collectively in the settlement of the problem of War debts. Thus a step forward was taken in regard

to the recommendations of the Basle Committee, which reported on 23rd December 1931 that "transfers from one country to another on a scale so large as to upset the balance of payments can only accentuate the present chaos. It should also be borne in mind that the release of a debtor country from a burden of payments which it is unable to bear may merely have the effect of transferring that burden to a creditor country, which, in its character as a debtor, it in its turn may be unable to bear. The adjustment of all inter-governmental debts, reparations, and other War debts to the existing troubled situation of the world (and this adjustment should take place without delay if new disasters are to be avoided) is the only lasting step capable of re-establishing the confidence which is the very first condition of economic stability and world peace. Although the German Government is energetically defending the stability of its currency, steps are necessary to secure that these measures shall have a permanent effect."

The service of the Dawes and the Young loans, which were commercialised, are no longer part of the reparations problem but constitute a first charge on the assets of the Reich. The interest on these loans amounts to the comparatively small sum of 90 million marks a year. It is to be remembered that although the proceeds of the Dawes loan were used partly to pay reparations, the primary purpose of the loan was to stabilise the budget of the Reich. One-third of the Young loan, amounting to about £20 millions, was applied to the financing of the German railways, the remaining two-thirds representing the commercialisation of reparations. In June 1934 the German Government made the strange proposal to default on both the Dawes and the Young loans by proposing to suspend for six months from 1st July all cash transfers on German medium and long-term debts abroad, including the Dawes and the Young loans. The British Government demurred to the proposal in its reply of 20th June to the German Note of 15th June.¹ The burden of the German debt, as shown in the previous chapter, is light—the *per capita* figure of £14·14 comparing favourably with that of Great Britain (£173·8), France (£158·6), and the United States (£44).² The service of the German external debt, taking the exchange at no more than 12 marks to the £, is for all forms of indebtedness, public and private,

¹ Cmd. 4620, 1934.

² *Vide* Table III on page 807.

only in the neighbourhood of £80 millions a year. The total cost of the Dawes loan is, for interest and sinking fund, 30 million marks and 21 million marks respectively, and for the Young loan 60 million marks and 14 million marks respectively—a total of 125 million marks out of a total external service charge of 971 million marks. By a careful analysis of Germany's foreign exchange income from invisible items and from exports, the British Government showed that the service of the loan could be provided for without difficulty (especially if the policy of the German Government were modified so as to stimulate exports) and threatened reprisals by setting up a debt clearing office for collecting and dealing with debts due from Germany to persons domiciled in the United Kingdom. The Board of Trade was also given power to impose quotas on imports if Germany imposed discriminating quotas on goods from the United Kingdom. The exports from Germany to the United Kingdom exceed the imports to Germany of United Kingdom produce and manufactures, and are sufficient to cover the interest on all German loans issued in London more than three times, and the interest on the London issues of the Dawes and the Young loans more than ten times. In view of these threats, Germany decided to continue the transfer of the interest on these international loans.

The history of reparations to the student of finance is of value from four points of view : (1) the burden of reparations ; (2) the importance of estimating the taxable capacity of the paying nation or nations before an indemnity is fixed ; (3) the important problem of transfer tackled with success by the Dawes Committee ; and (4) the dangers of inflation after an exhausting war if the Government is in any degree incompetent, weak, and vacillating. When indemnities are levied in future wars these factors, owing to the increasing solidarity of nations in trade and finance, will be of high importance, and the economists and financial experts must never be permitted to give way to the politicians, as was the case in the long and weary conferences after the Peace Treaty of 1919.

In regard to the burden of reparations Germany paid from 1st December 1924 to 30th June 1931 nearly 11,000 million marks, the equivalent of £502 millions. Of this sum 7949 million marks were made available under the Dawes Plan and 2,871,900,000 marks under the Young Plan. Before the Dawes Plan there is no accurate

figure of reparations. The Reparation Commission estimated that Germany paid in cash and kind up to the end of 1922 a sum of about 5500 million marks (£225 millions). If reparations for the year 1923 be added, the figure cannot be far short of £275 millions. This would make a total of £777 millions, which may be compared with the value to-day of the burden of the French indemnity of 1871 (£200 millions), viz. about £500 millions. There is considerable dispute as to the exact figure which Germany did pay in reparations before the Dawes Plan, and the calculation of the deliveries and payments alone is very difficult. The estimated value of the cessions, deliveries, and payments before the Dawes Plan have been estimated at 26,000 million marks (£1240 millions). The German estimate is no less than 33,000 million marks (£1574 millions). This figure must be regarded as a guess or as a statement of claims rather than an accurate financial total. In 1928–1929 reparations were only 12·4 per cent of the total cost of government in Germany, and 3·4 per cent of the national income. This does not seem an excessive figure. The 7 per cent Dawes loan amounted to 410·3 million marks and the 5½ per cent Young loan amounted to 1078·8 millions—a total of 1489·1 millions out of a total debt of 12,407·1 millions on 31st March 1934, or about 12 per cent of the total debt of the Reich. The annual interest on these two loans amounts, as we have seen, only to 90 million marks. No impartial person will deny that the effect of reparations has been the cause of much of Germany's economic and financial ills. But a great deal more has been due to her own actions, whether deliberate or unconscious, notably in the inflation of the mark in 1923. The responsibility for the final stages of the inflation which ruined the mark must rest with the German financial authorities, who, if they had had sufficient wisdom and courage, ought never to have permitted the mark to get out of control.

The main point, when indemnities are levied, is that they should, as far as practicable, be determined on the capacity to pay. The calculation of the taxable capacity of a country or countries is no easy matter, especially after a long and exhausting war, but it is vital that it should be estimated with care in order that it should be the basis of an indemnity and not the actual costs of reparations or war costs, which are entirely different matters, with nothing to do with what the vanquished country can pay. This concept is closely linked up with the trade-balance problem. Unless

there is a surplus of exports over imports, the foreign exchanges of the country paying the indemnity will go wrong and react on her currency. The future economic historian will doubtless recall how the Allies were perfectly within their rights in principle in demanding reparation as in previous wars. But he will also recall the cupidity of politicians and the stupidity of democracies clamouring for the squeezing of the lemon until the pips squeaked. The importance of the principle of taxable capacity is writ large on every page of the history of reparations, and in the future wars will doubtless be given the importance which it now holds in financial theory. Keynes' *Economic Consequences of the Peace* is a lasting monument to the importance of correct thinking in regard to the principle of capacity to pay. Had the original scheme of economists and financial experts been approved in the Conference at Hythe in 1920, and had Germany been allowed a reasonable period to accumulate working capital, it is quite possible that, as Stamp has pointed out, reparations might have been paid, and they would have led to no concentration of gold in particular centres and to no untoward circumstances such as have taken place.

The difficulty of transferring reparation payments has been already discussed, especially with regard to high tariff barriers and deflation. Creditor countries do not want to be paid in goods and services, the only reasonable method after the debtor country has paid all it can pay by direct means such as gold and securities. High tariff walls are raised to prevent payment in goods and services, the transfer of exports from the debtor country. The effect, too, on world trade from the debtor being unable to buy from his former customers is also forgotten. The Dawes Committee saw the importance of the transfer problem when it arranged that the Government of the Reich should raise taxes to a requisite amount in order to balance the budget, and it left to the creditors through a Transfer Committee to get the internal currency turned into the currency of the other countries without damaging German credit. These are indeed two connected questions, but are not, of course, two identical amounts. The principles governing the maximum in each case are totally different. The Special Committee supervised the transfer of marks into sterling, francs, and dollars. When this transfer is likely to be endangered by too small an export balance, the result of customers not wishing to

buy or an inflationary policy on the part of the paying Government itself, requisite steps must be taken. The lessons since the discontinuance of the Young Plan in Germany, especially from 1934, are well known. Germany really had never to face up to her real transfer problem until after 1930, because the amounts required for reparation between 1924 and 1931 were largely met by borrowing. During the first seven months of 1931 the withdrawal of foreign short-term money from Germany amounted to 20,900 million marks (£150 millions). There was also a certain amount of selling of long-term German loans by foreigners. An examination of Germany's capital transactions since 1924 clearly shows that less than half of Germany's actual borrowings can be attributed to the reparation payments which she was compelled to make. German borrowings reached the maximum about the middle of 1930, and the German official figure of foreign indebtedness given to the Young Plan (Basle) Committee was estimated at from 28,500 million to 30,000 million marks. The estimate of the Bank of International Settlement Committee was 25,500 million marks (£1000 millions). Between 1924 and the stoppage of reparation payments under the Hoover Moratorium the payments on reparation accounts amounted, as we have seen, to 10,400 million marks. Since 1931 there were withdrawals of foreign capital owing to lack of confidence in German financial policy, the result of an inflationary policy which was responsible for destroying Germany's capacity to export. As long as Germany maintains an overvalued currency whose exchange value is kept at an artificially high level in relation to internal prices, so long will she be unable to acquire a sufficiently large export surplus to pay her debts. She, therefore, must either reduce her internal costs or devalue her currency to its natural level, and not make, as has been well said, the best of both worlds at the expense of her creditors abroad.

The transfer problem in the future is likely to be even more difficult than in the past. The ease with which the indemnity of 1871 was transferred is not possible in the protectionist world to-day. The maintenance of a sufficient surplus export balance to meet reparations will not be easy. Lastly, there is the danger of inflation, the results of which will continue for many years after the actual inflation has passed. In 1935 Germany was still suffering from the incompetence shown especially in 1923 in regard to

the budget, when a policy of financing expenditure by the printing press was deliberately followed, and this is held to be the cause of most of Germany's troubles. No amount of technical banking advance, such as the new technique of blocked accounts, or indeed standstill agreements, will remedy the evils resulting from inflation. An inflationary policy impairs the exporting capacity of a country notwithstanding the temporary assistance of a depreciated currency. It may be an ingenious method for throwing the cost of a Government's programme of internal development on the shoulders of her foreign creditors. It is a danger, however, which must be considered in connexion with the levy of any war indemnity.

CHAPTER XXXV

THE REPAYMENT OF PUBLIC DEBT

1. THE obligation to redeem public debt has been recognised as a fundamental principle from the earliest period of the history of public debts. The United States has pre-eminently followed a policy of redeeming its public debt in periods of from five to forty years. After the War of Independence, the Civil War, and the World War, it followed a policy of redemption which had in view the extinguishing of the debt within about twenty-five years. It has no perpetual debt. Since 1802 it has not toyed with the delusion of a sinking fund built up by compound interest, but has paid off debt by the only sound method—by taxation. Great Britain also, but in a less degree, has adopted a policy of extinguishing the public debt since 1716, but the mirage of a sinking fund with compound interest took a very firm grip of her at various periods of the history of her debt. At the beginning of the twentieth century she gave up the policy of floating new debts on the perpetual debt method. Public debts are now either contracted as amortisable debts or converted into this form of debt as rapidly as possible. Debt is extinguished exclusively from taxes. The consolidation and redemption of the floating debt in Great Britain have been achieved with skill since the World War, although the floating debt is still fairly high. France, on the contrary, has never amortised her debt (except under exceptional circumstances), although in recent years there are signs in this direction. The methods followed are sometimes open to criticism, as borrowing to pay off loans is never in reality sound finance. The Government borrow ordinarily in perpetual *rentes*. The sinking fund which was established in 1816 never worked except for a few years, and it was not used to pay off debt. The sinking fund organised on

1st October 1926, the Autonomous Fund for Debt Redemption, was given a constitutional status and was made obligatory with special revenues attached to it, such as receipts from the tobacco monopoly. The excess of National Defence bonds issued over the amount redeemed are, along with taxes, the receipts of the fund. The French sinking fund, unlike the sinking funds of Great Britain, the United States, and Germany, is not cumulative. The fund has been raided from time to time. The French floating debt has resulted in severe financial crises at all periods of the history of the public debt, and the work of consolidating this debt in 1926 has been undone by the events in 1932-33 and subsequent years. In India, where four-fifths of the debt is productive, amortisation proceeds on the principle of repaying both productive and unproductive debt annually. In 1924 the method of redemption was co-ordinated and systematised on the following basic principles. "It is reasonable", said the Finance Minister in his Budget speech in 1924, "to fix different periods for the redemption of different classes of debt. For productive debt eighty years is not too long. For unproductive debt generally a period of more than fifty years is not easily defensible. For repaying the debt due to our deficits or for such an onerous obligation as the building of New Delhi, shorter periods, say twenty-five years for the first and fifteen years for the second, ought to be taken, since in both cases the next generation of taxpayers is in danger of being called upon to provide sums which ought strictly to have been met out of annual revenue. War debt, on the other hand, however desirable it may be to meet war expenditure to the utmost extent possible out of war revenue, is the inevitable outcome of war conditions and part of the cost of war, and may legitimately be passed on the generations which benefit by the sufferings and privations of their predecessors. *Per contra*, the fact that borrowing may be needed for emergencies such as war makes it most undesirable for a Government such as the Government of India to borrow for non-productive purposes in time of peace. It should manage to provide in peace time for the gradual amortisation of all its debt. Moreover, the existence of a regular provision out of revenue for reduction or avoidance of debt will not only reduce the net amount of our new borrowings for productive purposes but will materially reduce their cost."

The amount which is set aside annually does not accumulate at compound interest but is expended in the year in which it is provided, either on the actual repayment of existing debt or for new capital purposes in order to reduce the amount of new borrowings. By using the sums set aside for redemption in this way, the amount required in interest in the future is reduced.

In 1817 the British National Debt amounted to £848 millions. During a century of very unexampled increase in productivity the debt was, owing to a weak policy of repayment, reduced at a far slower rate than it ought to have been. By the end of the century (1899) it was reduced to £635 millions ; at the outbreak of the World War it stood at £706 millions. The period of the World War added £6775 millions to the National Debt, which stood on 31st March 1919 at £7481 millions. About fifteen years after the conclusion of the Peace, owing to the unusual financial disturbances of the post-War period when Europe was still an armed camp, and to the very large increase in expenditure on the social services, it stood at £7860 millions, viz. on the 31st March 1933. In the United States in 1801 the National Debt was \$83 millions, but at the end of the able administration of Gallatin in 1812 it was only \$45,200,000. In 1816 it reached the record level of \$127,334,000. The National Debt was entirely paid off by 1835, when the American Treasury began to amass a surplus which proved to be even more embarrassing than the previous debt. At the beginning of the Civil War the National Debt was \$74,985,000, and at the end of that war in 1865 it stood at \$2758 millions, of which less than half was funded. In the pre-War year (1913) the debt was only \$1029 millions, nearly three-fourths of which carried interest at the low rate of 2 per cent. On 31st August 1919 the American debt reached a new high level—\$26,597 millions—but practically all this indebtedness was held by United States citizens. By 1930 the debt had fallen to \$16,185 millions, but owing to the world depression again rose at the end of June 1934 to \$27,053 millions.

The advantages of debt reduction apart from the desire not to overburden posterity, the desire as it were of a careful parent to allow his children to enter into their inheritance unencumbered, are (1) the maintenance and strengthening of the national credit, which will be of great assistance in future conversion operations ; (2) borrowing with less difficulty when a national emergency

arises ; (3) the avoidance of the increased burden of the debt service when the general level of prices falls ; and (4) the setting free by redeeming debt of a larger volume of credit than otherwise would be possible for trade and other purposes. A consistent policy of providing for the reduction of debt increases confidence. Confidence grows where a Government shows an ability and keenness to honour the obligations which it incurs. Most national debts at the present time are unproductive debts, and with the increase of the size of the debt confidence is apt to decrease at a far greater rate. Hence the necessity arises for providing for the service of the debt—not merely the annual payment of interest but also the reduction of the debt which lies at the bottom of the whole theory of the sinking fund. “Our unceasing efforts”, said Ricardo in 1817, “should be directed towards paying off that part of the debt which has been contracted during war ; and no temptation of relief, no desire of escape from present, and I hope temporary distresses, should induce us to relax in our attention to that great object.”¹

The usual method of paying off debt is by the application of a surplus revenue. This surplus may be obtained by budgeting for a surplus of income over expenditure, or it may be obtained by arranging for a fixed amount of revenue in the Budget, *i.e.* taxation, to go to what is known as the Sinking Fund. When either this Budget surplus or Sinking Fund is obtained, the stock of bonds may be purchased in the open market direct by the Treasury, or through an official agency such as the National Debt Commissioners. Alternatively, the amount provided for in the Budget may be put to a cumulative sinking fund to “sink” the debt. There are two other methods, viz. redemption by terminal annuities and redemption by conversions. There are also methods of a more unusual or even revolutionary nature, such as (1) repudiation, including partial repudiation in the form of forced reduction of interest; (2) special differential taxation such as the very heavy taxation of higher incomes and the proceeds to be devoted to paying off debt ; and (3) a levy on capital.

The financial resources for the redemption of debt come exclusively from taxes. The repayment of debt, therefore, usually involves high taxation, which is frequently disliked by

¹ *Principles of Political Economy and Taxation*, ch. xvii. (McCulloch edition), p. 149.

the majority of taxpayers. The harmful effects of taxation are generally exaggerated in regard to the repayment of debt and would apply generally only to a scheme of redemption on a large scale, such as, for example, the redemption of the British National Debt within a period of thirty-five years by the establishment of a cumulative sinking fund of £100 millions or more per annum. A plan of this nature is similar to a capital levy, notwithstanding that it approaches the problem by means of a sinking fund. In such a case it would lead to an excessive strain on the taxpayer and would result, in all probability, in deflation. The psychological effects of fixing a date for the total redemption of the Public Debt which people up to fifty years of age may reasonably expect to see would be outweighed by the heavy taxation required. There is no formula which can determine the rate at which the repayment should proceed in any country. It is a choice between bearing a heavy interest charge year after year or making a greater present effort by higher taxation to secure the freedom from a continuing burden. The problem really resolves itself into a balancing between the bare effects of necessary taxation on the one hand against the benefits of a lower debt. This in turn depends on an examination of the taxation system and the comparative importance to be attached to each of these two factors, tempered by a consideration of the equity of distributing the burden of repayment among individuals of the present and future generations. It is sometimes suggested by industrialists that debt repayment should only take place after the prior claims of national production and trade are satisfied. But sums raised in taxation are not wholly diverted from productive purposes, nor is there, as is sometimes believed, a clear-cut fund of national savings available for trade purposes or for taxation. The revenue of the State is far from being a total loss to the industry, and sums applied to debt repayment do, in fact, become available for industry. Accordingly, the dislocatory effects of taxation are exaggerated. It is quite possible for a considerable volume of savings to be transferred by the State from taxpayers to debt-holders without dislocating industry in any way. It is erroneous to think that the repayment of public debt tends to impoverish a nation or to retard its industrial development. Government in repaying the debt is freed from providing an annual sum in the form of interest, and, from the point of view of

the amount of capital in the country, the nation is in no way poorer. By repaying the debt there is a transfer of funds from one set of citizens (taxpayers) to another (holders of debt). There is no destruction of capital; and there is at the most merely a readjustment of ownership in existing capital. It is a fallacy to argue that the repayment of capital obligations destroys capital. The bond-holders who are repaid may be deprived of their annual income in the form of interest, but they usually apply their funds to some productive purpose and, therefore, the proceeds of public taxes tend to be diverted into industry. Taxation for debt repayment is on the whole favourable to savings, although there is an element of disadvantage that the taxpayer's expenditure cannot be indefinitely restricted as this will interfere with enterprise. Additional taxation should be at least imposed to raise sinking funds to a reasonable and adequate level so that the programme of debt redemption does not entail a heavy new burden on the community. The maintenance of a regular sinking fund automatically makes available for other purposes a considerable revenue in emergencies such as war, when the sinking fund may be temporarily suspended. Moreover, a relative reduction in the interest charges in the total Budget, provided this has not already been made the occasion for commitments in other directions, will leave a corresponding margin for expansion. There will be room for emergency taxation as well as for emergency borrowing. The advantages, in short, to a country which systematically repays debt can scarcely be exaggerated.

SINKING FUNDS

2. One method of reducing debt, usually deadweight debt, is, as we have seen, by a sinking fund. The normal sinking fund is a fund set aside annually in respect of a given loan or loans so that the accumulated total, including compound interest, will be sufficient to redeem the loan or loans at the time of maturity. It is formed, in short, by setting aside a certain amount of national revenue for the reduction of the principal of the debt. A sinking fund has, as history shows, been a snare when it is not carefully managed. It must be the genuine result of a surplus of revenue, of the proceeds of taxation, and not of money which has been in effect borrowed. One-half of the actual receipts of the sinking

fund before 1828 was raised by loans. While the fund was accumulating further debt was incurred, so that the reduction of debt was far from being real. Moreover, money was borrowed at over 5 per cent during the Napoleonic wars, while the previous loans, to the extinction of which a sinking fund was devoted, were carrying only $4\frac{1}{2}$ per cent. Debt was incurred at a high rate of interest to pay for debt at a lower rate of interest, the sinking fund being considered "as a means by which a vast treasure was to be accumulated out of nothing"! This policy was abandoned by the United States in 1817 and by Great Britain in 1829. Was it not without reason that McCulloch called it "this worthless compound of delusion and absurdity"? He added, "We doubt if the history of the world can furnish another instance of so extraordinary an infatuation". Where it is allowed to accumulate at compound interest, as in Pitt's experiment of 1786 (which is based on Dr. Richard Price's scheme¹), there is great danger of its being diverted from its purpose, and the debt increased instead of diminished. The history of British Sinking Funds described in the following chapter makes this clear. Professor Robert Hamilton² in 1813 enunciated the principle that the excess of revenue over expenditure is the only real sinking fund by which public debt can be discharged. Hamilton's ideas, greatly assisted by Lord Grenville's *Essays* in 1827, triumphed and were accepted by a Select Committee of the House of Commons in 1828, so that in the following year all the previous legislation was repealed. The Select Committee suggested that a surplus of £3 millions in the Budget should be provided annually, but if the annual budgets are examined from 1829 to 1869 and the three war years 1854-55 to 1856-57 be excluded, it will be found that the average annual amount of actual surplus revenue appropriated to the sinking fund during the remaining period of thirty-seven years was only about £1,300,000.³ This sinking fund, known as the Old Sinking Fund, exposed the fallacy underlying the fund of 1786, which assumes that public debt adds to the net income of a country,

¹ *An Appeal to the Public on the Subject of National Debt*, London, 1771; new edition, 1774.

² *Enquiry concerning the Rise and Progress, the Redemption and Present State and the Management of the National Debt of Great Britain* (Edinburgh, 1813).

³ *Vide Appendix 13, Accounts relating to the Public Income and Expenditure of Great Britain and Ireland*, vol. ii. No. 366—I—1869, pp. 721-9.

being, it was thought, productive property—an assumption which would have been true had the money been invested abroad and the interest received regularly and paid into the sinking fund. Dr. Richard Price failed to see that the principal as well as the accumulated interest and compound interest must be derived from taxation, and that in consequence the supposed gain to the taxpayer is purely illusory. The sum to be invested annually to reduce debt must be from taxation or savings, and the accumulation of the interest upon all such sums must be used for the same purpose. Since under the Old Sinking Fund no real effort was made to provide the sum required annually—£3 millions—a New Sinking Fund was formed in 1875 for the acceleration of repayment by a permanent annual debt charge which covered not merely the entire service of the debt (the payment of interest, terminal annuities, management, and specific sinking funds) but left a margin which would redeem the debt. This margin was the New Sinking Fund. As the interest charge fell owing to the reduction in the debt the margin set aside for the redemption of the debt would automatically increase. As is shown in the subsequent chapter, the New Sinking Fund fell from £27 millions in 1875 to £24½ millions in the pre-War year (1913–14). In that year the New Sinking Fund amounted to £5,228,000, or about 0·8 per cent of the total debt. The principal of terminal annuities amounted to £2,377,800, so that the total issued for debt redemption out of the fixed debt charge was £7,605,880, or 1·15 per cent of the total debt. From the outbreak of the War to the end of 1919–20 the New Sinking Fund was suspended, as is not unexpected in time of war. In view of the large debt created, the debt could not be brought within the fixed-debt charge of the Sinking Fund, and there was a change in procedure owing to war exigencies. Certain specific sinking funds were attached, as explained in the following chapter, to loans issued during the War, such as the 3½ per cent Conversion Loan, the 4 per cent Victory Bonds, and the 4 per cent Funding Loan 1960–90, in order to make these more attractive to the investor. In the Finance Act of 1923 the fixed-debt charge arrangement of 1875 was repealed, and a definite annual provision for sinking funds was set up unless and until Parliament otherwise determined. A sum of £40 millions for the year 1923–24, £45 millions for the year 1924–25, and £50 millions for the year 1925–1926 and subsequent years, was allotted for the non-cumulative

sinking fund. The annual amounts fixed by this Act for National Debt Services and charged on the Consolidated Fund included the sums which must be issued under the specific sinking funds referred to and also the capital of any terminable annuity falling due. The greater part of the New Sinking Fund was required to meet these obligations, and the free balance issued to the National Debt Commissioners to redeem debt, for example in 1925–26, was only £9,991,000. With much truth the Committee on National Debt and Taxation emphasised the principle that sinking funds should be strong. They recommended that the Sinking Fund should be increased to £75 millions a year and hoped that, through reductions in the interest charges from conversions and redemptions, expanding revenue, and perhaps from payments to Great Britain by Allies, this proposal should be quite practicable within a short time. They also held that immediately after the War period specific sinking funds for certain loans were a distinct advantage in securing the success of the loans. “From the point of view”, the Committee added, “of the use of the Sinking Fund in raising Government credit and facilitating operations under more settled conditions, we are, however, inclined to think that definite attachment to particular loans tends to be disadvantageous. The present specific sinking funds are, in the main, attached to the longer term loans, and in one case, to funded debt; that means that, upon the maturity of short issues, reborrowing (or conversion) has to be *pro tanto* greater than if the whole Sinking Fund had been free and available for such payments. The repayment of one type of stock side by side with reborrowing in another type is probably on the whole more disturbing to values than a simple reborrowing of a smaller sum. Nor can it be foreseen with any certainty that the stock to which a sinking fund is attached will prove to be that which over a long period it is most desirable to support. Leaving out of account the possibility that hypothecation may be a means of ensuring the continuance of the sinking fund provision, the ends in view can be equally secured by a judicious use of a free sinking fund; on the whole we do not therefore favour any extension of the earmarking of the sinking fund to particular securities.”¹ In the Budget of 1928–29 a fixed sum of £355 millions was to be applied annually to the consolidated service, that total including the Sinking Fund. The change effected

¹ Cmd. 2800, 1927, para. 217.

in 1928–29 would have made the restoration of the Sinking Fund similar to that of 1875. With a fixed amount applied to the National Debt the amount available each year for actual National Debt redemption should have increased in cumulative fashion owing to debt redemption in the previous year. Indeed it was proposed in restoring a fixed-debt charge which had been in abeyance since the World War to provide for the complete extinction of the British National Debt, in the absence of any further addition, within fifty years' time. History, however, proves that these allocations are not always inviolate, since, as the Committee on National Debt and Taxation has pointed out, “there was no possible device which could absolutely ensure the continuance of debt redemption, if the Government of the day decided on a contrary policy”. The total debt charges varied in subsequent years, especially owing to the onslaught of the economic blizzard in 1931. The total amount spent on National Debt Service in 1930–31 was £360 millions, of which £66,830,431 was for the National Sinking Fund. In 1932–33 this had fallen to £308½ millions and the contribution to the National Sinking Fund was only £26,330,450. Another drawback to the fixed-debt figure is that there is always the possibility of the Sinking Fund being materially weakened if money rates are particularly high during the year. When the State has a considerable floating debt, the amount required for interest may vary considerably with a rise or fall in interest rates. A difference of one per cent either way in the value of money affects the interest charge on Treasury bills alone to the extent of several millions sterling.

The Sinking Fund method of retiring public debt includes various methods, such as the cumulative principle, the attachment of special revenues, the payment of a definite sum yearly, and the payment of an annual Budget surplus, and sometimes more than one method is combined in a single budgetary system. The casual surplus of a Budget in these days of close estimates is not very effective. It is, therefore, essential to provide in the Budget by a regular appropriation a sum from revenue. This sum may be fixed in amount or it may be a certain percentage of the outstanding debt, or it may be progressive, and it should be capable of suspension in emergencies. The method of progressive amortisation allows for growth in population and wealth. Each payment is made up of the original fixed payment, and the total

annual interest is thereby reduced or released. The progressive Sinking Fund is perhaps the best method of amortisation yet discovered. The Sinking Fund has been attacked on the ground that it is seldom properly managed. It requires expert financial management by an administrative department; the funds must be invested in bonds that can be easily liquidated; and the fund must never be raided or misappropriated. In view of these difficulties some have held that the safest method is the simple retirement on a regular system of the bonds or script. Since 1930 about half of the states in the United States have made the amortisation of debt compulsory in this way. For National Governments the definitely revealed and fixed Sinking Fund is still with reason popular. The difficulties of the management can be to some extent got over by the appointment of an official body as in Great Britain, the National Debt Commissioners, who are in close touch with all matters relating to the efficient redemption of National Debt, and who may purchase stock on the market whenever conditions are favourable. One per cent of a Sinking Fund on the entire debt of a country has usually a very bracing effect on Government credit, and it shows the good point of the Sinking Fund, especially in public loans of a limited currency such as the great majority of funded debts now are.

CONVERSION OF PUBLIC DEBT

3. In order to lighten the burden of a public debt resort is frequently had to the conversion of existing debts into debts carrying a lower rate of interest. This process, known as conversion, is possible when the existing rate of interest is lower than the rate that prevailed when the debt was floated. It is clear that the consent of lenders is necessary, and the State as a rule makes it possible for the creditors to make a choice between the redemption of the debt and acceptance of the new loans at a lower interest rate. Conversions must be sufficiently advantageous to be converted or the holders of the loan will ask for redemption. Governments reserve the right to redeem the loan with due notice or they give a date after which the loan may be repaid, which is known as the period of inconvertibility. The loan cannot be redeemed before this fixed date unless there is a provision to this effect at the time of the flotation of the loan.

The Treasury usually gives only a limited period for the holders to make up their minds. In the French conversion loan of September 1932, which dealt with securities issued between 1915 and 1927 amounting to about 86,000 millions of francs (equivalent to £966 millions), the French bond-holder was given only six days, a much less generous interval than the three months allowed by the British Government in their large conversion scheme of the same year. Holders who did not notify their desire for redemption were deemed to have accepted the conversion offer. To make a conversion certain the scheme should be simple and timely. Anything likely to be misunderstood by the public will weaken the chances of a successful conversion. The psychological moment for making a conversion must be carefully considered. The British Treasury, for example, is in close touch with the Governor of the Bank of England and with the City, and similarly in the case of Treasuries or Ministries of Finance in other countries. The State must not offer such advantages to the holder as would cancel the benefit of the conversion for the State. These simple principles have been followed in Great Britain, the United States, France, Italy, Switzerland, the Dominions, India, and other well-financed countries. In the following chapter the history of conversions in the case of the British National Debt shows how these principles have been followed in practice.

The capital of the debt should never be increased unless for exceptional reasons. Government loans should not be issued at a heavy discount but at par or at a figure not very appreciably below par. These maxims have not always been followed. Thus between 1776 and 1785, troublous times for British finance, for £92 millions borrowed no less than £115 millions were to be repaid. In 1815 at the end of the Napoleonic wars a large loan was raised at as much as £174 in 3 per cent stock for £100, and for the total National Debt on 5th January 1817, amounting to £796,200,191, only £563,600,638 were received.¹ Many of France's loans in the nineteenth century were issued from 52½ to 84 per cent, one loan in 1848 being as low as 45 per cent. The rate of interest was usually 5 per cent. Similar extravagance was not altogether unknown in the critical days of the Great War. If there is a guarantee against a further conversion for a period

¹ *Accounts Relating to the Public Income and Expenditure of Great Britain and Ireland*, vol. ii. 366—I—1869, p. 554.

this will ensure, *ceteris paribus*, a successful conversion, as in the case of the 5 per cent War Loan which was converted successfully in 1932,¹ when the Government decided, as announced in the House of Commons on 30th June 1932, not to redeem the new Conversion Loan before 1st December 1952, *i.e.* five years later than the latest date for repayment of the loan under the original War Loan scheme. After that date the Government reserved to themselves the right to repay the loan, at any time, either in a single operation or by instalments. The Loan was made all the more attractive by the fact that the existing arrangement under which the interest was paid without deduction of income-tax at the source—a special privilege which has proved itself a great convenience to an enormous number of small holders—was continued unchanged. By the terms of the 5 per cent War Loan prospectus three months' notice for redemption had to be given, and in order that the Government should know in so large an operation where they stood and in order that they might have ample time to take such remaining measures as were necessary, they offered a cash bonus at the rate of £1 for every £100 of stock to all those holders who, not later than one month after the conversion was announced, assented to continue in the Loan. This cash bonus in the case of the ordinary investor was not liable to income-tax and was paid to each holder within fourteen days from the date of the receipt of his effective assent. Those who did not assent were to receive payment in cash approximately two months after the expiry of the three months' notice to redeem. There were nearly three million people who held War Loan, and arrangements were made to inform each holder, great and small, of the details and policy of the conversion by sending a prospectus, documents, and a letter signed by the Chancellor of the Exchequer. Fifteen million forms were despatched to the holders of the Loan within twenty-four hours; the publicity was arranged very deftly, and a small commission was paid to bankers, etc., whose clients play so important a part in all conversions. As is shown in the following chapter, 92 per cent of these holders assented to the conversion of the War Loan, which meant that only £165 millions out of £2087 millions or 7·9 per cent dissented. This small balance was paid

¹ Beginning with the dividend payable on 1st June 1933, the rate of interest was reduced from 5 to 3½ per cent per annum.

on the 1st of December without any difficulty. Those who gave notice of redemption were usually banks and other professional dealers in credit, the nature of whose business prevents them from holding more than a certain proportion of their assets in long-term stocks like War Loans. The boldness of the conception of the Loan and the attention to detail were the main causes of its success.

REPUDIATION

4. By refusing to admit the validity of its obligations a Government may be said to repudiate its debt. Repudiation may be complete or partial. The best example of the former is the case of Soviet Russia in 1918, and several States of the American Commonwealth such as Mississippi and Florida in the nineteenth century, which have already been referred to in Chapter XXXII.¹ Partial repudiation is seen when the burden of the debt is lightened indirectly or in concealed form by depreciation of the currency (as in Germany in 1923 where excessive inflation took place), i.e. by the use of the printing press, which lightens the burden of the debt from the State's point of view. Partial repudiation

¹ The Council of Foreign Bondholders prepared a statement showing the amount of debts in default. These are as follows :

State.	Description of Debt.	Approximate Amount in default (in dollars)
Alabama . . .	Guarantees to railways, etc.	13,000,000
Arkansas : . .	Principally railway guarantees	8,700,000
Florida . . .	Bonds issued to establish banks and for railway guarantees	8,000,000
Georgia . . .	Principally railway guarantees	13,500,000
Louisiana. . .	Baby Bonds, railway guarantees, and Certificates of Claim issued under Settlement of 1874	6,000,000
Mississippi . .	"Planters" Bank Bonds (1831-33) . . . 2,000,000	
	Union Bank Bonds (1838) 5,000,000	
		7,000,000
North Carolina . .	Special tax bonds and railway guarantees	13,000,000
South Carolina . .	No details available	6,000,000
		75,200,000

The table does not include Confederate bonds or Civil War debts. In view of the 11th Amendment to the Constitution no individual can bring a suit against the State in the United States Courts of Justice.

was also seen in the case of the United States in 1933, when the gold clause was abrogated in all public and private contracts and payment in paper currency was substituted for payment in gold. Sometimes a special tax is imposed on the interest dividends, as in Austria in 1868 and in Russia in 1885, and this is a form of partial repudiation. Compulsory interest reductions have been made in recent years in Germany and in 1935 in France, where a 10 per cent cut in general expenditure was extended to the interest on *rentes*. In a policy of budgetary deflation, such as the French Government decided on in July of that year, this step was taken in order that the rentier should not escape scot-free for a considerable length of time. It was thus introduced to overcome the objection to budgetary deflation, viz. that its incidence is inequitable since the rentier escapes unless the interest is decreased. A simultaneous and proportionate cut on all Government expenditure, including interest on the National Debt, is fortunately rare in this age of capitalism, where the sanctity of contracts is a cardinal principle of constitutionalism, and it may be better to get at the real cause of a country's difficulties when her currency is much overvalued and to devalue, as the rentier may lose more by deflation than by devaluation in regard to his real income. Repudiation should be distinguished from default, which implies simply an inability to carry out the terms of the contract without denying the liability. When default results in repudiation, the distinction between the two vanishes. Repudiation itself does not always mean inability to pay, and must not therefore be regarded as the bankruptcy of the State. It is usually due to considerations of a political or social nature and sometimes to overborrowing for unworthy purposes. Reduction in the rate of interest unilaterally, the postponement of the date of the payment of the principal, and the reduction of the principal of the debt are the usual forms of repudiation. The effects of full and even partial repudiation of an internal debt are frequently very severe, especially when the class of small investors put, as in France, their savings into Government Loans. To them it means the deprivation of their earnings and life savings to such an extent that they may find it necessary to fall back on the State's support. Repudiation may result in driving capital out of the country, to the injury of the country both from economic and social

points of view. It affects practically all creditors, since creditors are debtors who find it hard to pay if they themselves are not paid. Repudiation, in other words, tends to set up dislocation within the State and to produce a string of bankruptcies. If the loan is an external one it affects, other things being equal, foreign countries at the expense of debtor countries.

Repudiation is an act of sovereignty, and the State possessing that sovereignty may allege that it does not have the resources necessary to carry out the award of the arbitrator. A method of solving the State's repudiation is that of arbitration, and it is customary for foreign creditors to form protective associations. Sometimes it is possible to secure the services of a friendly power. The Government which intervenes may threaten to prohibit the listing of the securities of the defaulting State on its stock exchanges or to refuse to permit the raising of money in its money markets until an agreement has been arrived at. Sometimes the foreign creditors may get their Government—also a sovereign State—to contest the act of repudiation. The right of repudiation is obviously more limited in the case of foreign debts than in the case of domestic debts.

THE CAPITAL LEVY

5. The growth in public debts and the resulting large demands in the form of interest charges made the question of the repayment of public debts after the War an urgent one. One method suggested to achieve this end was to wipe out a large part of the public debt by a levy on capital itself for the specific purpose of sinking the debt. The problem is to examine whether the injurious economic results of recurring annual taxation are less than the effects of a capital levy. The feasibility of a capital levy will not be denied even by its strongest opponents, provided it is received with a fair amount of approval. General assent is required. If there was opposition from the banks, if another capital levy was feared, if the general level of prices was falling and commerce and industry depressed and nervous, it would not be likely to succeed. The Professor of Political Economy at Cambridge and others put forward the case why a capital levy should be undertaken in Great Britain in preference to paying off debt over an extended period. Pigou, however, later came to

the conclusion that if it had been introduced immediately after the War it might well have proved beneficial, but if introduced now it would probably be harmful. The British Labour Party in November 1923 issued their programme, in which it was stated that "Labour condemns the failure of Government to take steps to reduce the dead-weight War debt. No effective reform of the national finances can be attempted until the steady drain of a million pounds a day in interest is stopped. Treasury experts, in evidence before a Select Committee of the House of Commons,¹ expressed their view that a tax on War fortunes could be levied, and have, therefore, admitted both the principle and its practicability." The Board of Inland Revenue is of opinion that a capital levy would be a task of the first magnitude even in the most favourable circumstances, but it does not regard the difficulties as insuperable. The task would be similar to that regularly undertaken for purposes of Estate Duty and would be less difficult than a levy on War wealth.² The Board, however, points out very forcibly that the administration of the tax depended on the absence of systematic and widespread obstruction and of all anxiety regarding the consequences of the levy. The latter would affect capital values so as to make the tax uncertain in its result. The Chancellor of the British Exchequer appointed in 1924 a Committee to examine the subject, which really resolves itself into two main questions : (1) a question of principle, and (2) a question of technique. The Committee, of which Lord Colwyn was appointed Chairman—Lord Colwyn was Chairman of the Royal Commission on Income Tax, 1920—was asked "to consider and report on the National Debt and the incidence of existing taxation, with special reference to their effects on trade, industry, employment, and national credit". The opinion of witnesses before the Committee was that the levy must be confined to individuals and there must be an exemption limit. With the lowering of the exemption limit the difficulties become all the greater. If large sums are required steep graduation will be

¹ Cf. *Report from the Select Committee on Increase of War Wealth*, together with the *Proceedings of the Committee, Minutes of Evidence and Appendices* (102 of 1920).

² Appendices to the Report of the Committee on National Debt and Taxation (London, H.M. Stationery Office, 1927). Note by the Board of Inland Revenue on the practicability of a capital levy (Appendix XXII.) and on the yield of certain scales of capital levy and the consequent effect and yield of income-tax, super-tax, and Death Duties (Appendix XXIII.).

imperative. The Committee concluded that "even if there were a prospect of a Capital Levy being well received, the relief from debt which it offers would be insufficient to justify an experiment so large, difficult, and full of hazard ; this would hold good in any circumstances not differing widely from those of the present time. Further, unless a levy were accepted with more goodwill than it would be possible to anticipate under present conditions, it would be highly injurious to the social and industrial life of the community."¹

The case for and against a capital levy has been ably set out by many writers.² The proposal of the British Trade Union Congress and the Co-operative Congress was to have a special levy on accumulated wealth, the yield of which should be at least £3000. The British Labour Party was generally in favour of exempting fortunes up to £5000. Beyond this exemption progressive taxation would take place. Capital rather than income would be taxed, and the payment was to be made quickly, but exemptions were to be granted in a small number of cases. The rate of taxation is seen in the tables on opposite page.

On the analogy of estate duties a law would be passed by which, as one writer phrases it, "every man and woman of a suitable degree of wealth would be deemed to die and to come to

¹ *Report of the Committee on National Debt and Taxation*, Cmd. 2800, 1927, para. 876.

² The case for a War debt redemption levy is set out in the following books : *Labour and the War Debt, a Statement of Policy for the Redemption of War Debt by a Levy on Accumulated Wealth* (London, 33 Eccleston Square, S.W.1, Labour Party) ; Pigou, *A Capital Levy and a Levy on War Wealth* (Oxford University Press, 1920), cf. *A Study in Public Finance*, Part III. ch. vi. (Macmillan, 1928) ; Dalton, *The Capital Levy explained* (The Labour Publishing Co., London, 1923) ; Pethick-Lawrence, *A Levy on Capital* (London, Allen & Unwin). The case against a War debt redemption levy is set out in the following books : Pennefather, *The Capital Levy exposed* (London, Hutchinson & Co.) ; Harold Cox, *The Capital Levy, its real purpose* (The National Unionist Association, Westminster), cf. *Report and Evidence of the Select Committee on Increase of the War Wealth* (102 of 1920) ; *Economic Journal*, March 1919 ; September 1920, Professor Corrado Gini on the Italian Law. The following should be consulted : *Report of the Committee on National Debt and Taxation* (Cmd. 2800, 1927) ; Chlepnner, *Le Prélèvement sur le capital dans la théorie et la pratique* (Brussels, 1925) ; Raiter, *Le Prélèvement extraordinaire sur le capital en France et à l'étranger* (Paris, 1927).

Ricardo was in favour of a capital levy. He proposed to levy a high property tax to pay off the National Debt. "I should", he stated in the House of Commons, 21st February 1823, "contribute any portion of my own property for the attainment of this great end if others would do the same." Cf. Preface to *Letters of Ricardo to Malthus*, ed. L. Bonar (Oxford, Clarendon Press, 1887).

life again next morning as the fortunate heir to his or her own property on payment of an appropriate ransom". It was to be levied on individuals but not on corporations. Relief will be afforded, it is argued, to trade and industry consequent upon the

		Scale of Levy.	Levy Per Cent.
First	£5,000 . .	£0- 5,000	0
Next	£1,000 . .	£5,000- 6,000	5
"	£2,000 . .	£6,000- 8,000	10
"	£2,000 . .	£8,000- 10,000	15
"	£5,000 . .	£10,000- 15,000	20
"	£5,000 . .	£15,000- 20,000	25
"	£10,000 . .	£20,000- 30,000	30
"	£20,000 . .	£30,000- 50,000	35
"	£50,000 . .	£50,000- 100,000	40
"	£100,000 . .	£100,000- 200,000	45
"	£300,000 . .	£200,000- 500,000	50
"	£500,000 . .	£500,000-1,000,000	55
Remainder	. .	Above 1,000,000	60

This scale would work out as follows :

A man worth not more than £5000 would pay nothing.		Per Cent of his Total Fortune.
A man worth £6,000 would pay . . .	. . .	. £50 or 1·2
" £8,000 " . . .	. . .	. £250 ,, 3·2
" £10,000 " . . .	. . .	. £550 ,, 5·5
" £15,000 " . . .	. . .	£1,550 ,, 10·3
" £20,000 " . . .	. . .	£2,800 ,, 14·0
" £30,000 " . . .	. . .	£5,800 ,, 19·3
" £50,000 " . . .	. . .	£12,800 ,, 25·6
" £100,000 " . . .	. . .	£32,800 ,, 32·8
" £200,000 " . . .	. . .	£77,800 ,, 38·9
" £500,000 " . . .	. . .	£227,800 ,, 45·6
" £1,000,000 " . . .	. . .	£502,800 ,, 50·3
" £2,000,000 " . . .	. . .	£1,102,800 ,, 55·1
" £3,000,000 " . . .	. . .	£1,702,800 ,, 56·7
" £10,000,000 " . . .	. . .	£5,902,800 ,, 59·0

remission of taxation made possible by the extinction of debt and the cessation of debt interest. This reduction of taxation in future would reduce the bad effects of taxation on production, and would make it possible for money to be devoted to social services, such as education, to an increased extent. A State levies death duties and gives protection to the accumulation of wealth. For the same reason it has the right to take a part of

the capital. It is also argued that it is most unfair that millions of men who fought in the War, perhaps the most enterprising part of the community, must labour to provide interest on money which others (who stayed at home and in many cases did well out of the War) were able to lend in large amounts while they were fighting. "If it was right that young men should give their lives, it was right that rich men should give their wealth in taxation, instead of being invited to make a profitable investment."¹ Again, a larger proportion of the cost of the War should have been taken by taxation. Therefore, it is argued, take it now in its capitalised form. Another argument put forward is that if, as is not unlikely, a general fall in prices takes place, the burden of debt will increase, and the holders of Government securities will gain still more at the expense of the taxpaying community. Therefore it is held a levy is expedient. The effect on the money market of a capital levy is said to be exaggerated by bankers and similar opponents of the measure, since the payment is spread over a period and the Treasury pays the money out as fast as it gets it in. This last argument especially will require careful examination.

With a capital levy as a means of effecting the better distribution of wealth we are not concerned. The proposal must be examined from the financial standpoint. Is it an efficient means, as compared with annual taxation, to reduce public debt? The proposal is not a new one, for in 1716 Hutcheson proposed in the House of Commons that 10 per cent on all property, including the debt itself, should be levied in order to repay debt.² Hume³ and McCulloch,⁴ in commenting on this, held that the poor would not pay, that it would be unfair, and that evasion would be easy. Ricardo defended the levy in his essay on the Funding System and in his parliamentary speeches. Mill in his *Principles of Political Economy* rejected the plan in 1848. The proposal to repay debt by a capital levy seems to occur after every great war or calamity. It will, therefore, be necessary to examine (1) the operation of capital levies in other countries, and (2) to review the

¹ *Labour and the War Debt*, p. 5 (The Labour Party, 33 Eccleston Square, London, S.W.1).

² *A Speech made in the House of Commons, 24th April 1716*, by A. H. (1716; 2nd edition, 1722); cf. *Collection of Treatises relating to the National Debts and Funds* (London, 1721).

³ *Essay on Public Credit Political Discourses* (Edinburgh, 1752).

⁴ *Taxation and the Funding System*, p. 464 (London, 1845).

evidence regarding this difficult question, with special reference to Great Britain.

A levy for economic ills has been tried in several countries, notably in Poland, in Czechoslovakia, Italy, Germany, Austria, Hungary, and Greece. It was also proposed towards the end of 1923 in Switzerland. With the exception of Switzerland, the levy was tried as a desperate remedy.

In Poland, by a law of 16th December 1921 and by a new scheme introduced in August 1923, a capital levy has been twice imposed. Wealth in Poland, as is well known, is more unequally distributed than in perhaps any other country of the world. There are family estates, it is said, equal to English counties, whose owners buy racehorses in England in spite of the adverse exchange, and, as has more than once been pointed out, the annual income of this class is probably equal to the total wealth of thousands of their poor compatriots. The result of the Polish levy is that it produced far less per head of population than the British income-tax and super-tax, £1 : 8s. for the Polish capital levy against £8 : 10s., the revenue from property incomes and super-tax in Great Britain. The levy in 1922 brought (in Polish currency) seventy milliard marks. The gain to the State was wiped out by the subsequent depreciation of the currency. An able Finance Minister was the means of introducing the levy into Czechoslovakia in 1919. The tax was in effect a tax on property, payable chiefly from income, and may be taken to be a kind of super-tax rather than a levy on capital. The President of Czechoslovakia remarked that "I am not satisfied with the result. The money seemed to disappear." The levy on capital by the law of 22nd April 1920 was on all fortunes in excess of 50,000 crowns and was on a sliding scale varying from 4½ per cent to a maximum of 50 per cent on fortunes above 100 million crowns. Payment was to be made in ten years or twenty years and extensions were granted in certain cases. The assessment was on the value of the property on 1st January 1920 and the yield of the tax was estimated at between 10,000 million to 12,000 million crowns, but the actual yield was 6000 million crowns, or approximately only 600 million gold francs (£24 millions). This capital levy was closely connected with the punitive laws of 1918 and 1919 for the confiscation of lands and was aimed especially at Austrian landlords in the new Czechoslovakia.

slovakia state. In Italy the capital levy of 1920, which was modified in 1922, was a tax on property distributed over twenty years, and thus lost all the characteristics of a true capital levy, becoming merely a supplementary income-tax. It has given rise to considerable difficulties in regard to the valuation of property. The valuation was fixed in 1919–20 at a time when values were fluctuating greatly. The payment was spread over so long a period that it resembled an annual tax on capital, and the distinct features of a levy, as usually understood, were therefore absent. The capital levy extracts from the pockets of the taxpayers a considerable sum instead of a succession of smaller sums over a period of years, and this deprives them of property which would otherwise have yielded them an income. A special levy is less fair than the annual taxes, because the former does not take into account the family responsibilities of the taxpayer at the moment of the levy as in the case of income-tax. It also takes no account of the recurring good fortune resulting from bequest in the way that income-tax does. If A inherits a fortune after the levy he does not pay to the extent that B does who receives a fortune just previous to the levy. In this respect a capital levy is inferior to an income-tax from the point of view of distribution, and a study of continental legislation brings out clearly how even when the levy is spread over a period these difficulties arise. In Germany, Erzberger attempted (1) a levy on capital, and (2) a non-recurring war levy on increases in property values, but its defects were nullified by the rapid depreciation of the mark. The law of 31st December 1919 which introduced the *Reichsnatopfer* had provisions for postponed payments, and the impost thus became not a capital levy but a supplementary income-tax. The sums collected by the law of 8th April 1922 on the *Vermögenssteuer* (ordinary tax on capital) were also spread over a number of years, and moreover the proceeds were used not to pay off debt but as ordinary revenue. Austria's attempts have been somewhat similar. "No salvation", says an authority, "came from this panic measure, and when the League of Nations took over the administration of the country it would have nothing to do with it." In Hungary there was much evasion. "The cautious capitalist", according to an official report of March 1923, "promptly did his best to secure himself against further risk by removing his mobile capital out of harm's way." In Hungary,

as in Austria and in Germany, capital levies enacted in 1919 and 1920 at high rates were rendered ineffective by the rapid depreciation of the currency. In Greece in 1923 a capital levy was introduced, the percentage being fixed on each stage of a man's wealth. The rates were so low as to render comparison impossible with any scheme for a levy in an important industrial country such as Great Britain. All national loans and remittances from emigrants, as in Italy, were exempt. The date of the valuation of property was, as in Czechoslovakia, prior to the passing of the Act.

The case of Switzerland in 1923 is similar to that of Great Britain. There was as in Great Britain stringency, unemployment, and a heavy debt. In both countries, however, there was no hopeless condition of the public finances. The purpose of the levy, which was introduced by the Socialist Party, was to provide funds for social reforms. Under the Swiss Constitution any 50,000 citizens may initiate legislation. Both chambers of the legislature rejected the proposal by overwhelming majorities, and the State referendum resulted in 730,584 votes against the proposal and only 109,434 in its favour, and over 86 per cent of the voters on the list went to the poll. All the cantons and all towns with a Labour majority disapproved of the result, which was objected to by a majority of 7 to 1. The minimum wealth to be taxed was to be the equivalent of £3200, at a rate varying from 8 to 60 per cent. In one week it is said the withdrawal of bank deposits amounted to one million francs. Bonds and shares were sold to foreigners, who were exempt, and reinvested in foreign securities. The State funds fell on an average by 2 per cent in one week, and other securities lost 1 per cent of their value. The anxiety and depression which followed upon the threat of a capital levy, even though there was no prospect of the levy being carried through, were striking. The object of the levy differed from that of most capital levies. The Swiss capital levy was intended to provide for social benefits and not to redeem public debt. Its scope was wider than a capital levy, such as was proposed in Great Britain by the Labour Party, as it was intended to include companies as well as individuals. The result of the referendum restored confidence in Switzerland both at home and abroad. A caveat must be added with regard to the experience of other countries in the post-War period. These must be judged with

care as they differ considerably from the levy that was proposed in Great Britain after the War.

The British debt at the end of the War (£7481 millions) was indeed a large sum, and to repay £3000 millions of debt was not an easy matter. It is interesting to note that the National Debt of Great Britain at the close of the French War (1817) was £850 millions, and the national income was estimated at £400 millions. The ratio of debt to income was therefore $2\frac{1}{3}$ times the income. At the close of the Great War (1918) the National Debt was £7829 millions, while the national income was £3900 millions. The debt, therefore, was in the proportion of 2 to 1, or slightly lower than in the war which ended a hundred years earlier. If the proportion of debt to national wealth be taken it will be found that the percentage of debt to wealth was 32 in 1817, and 34 in 1919.¹ It is necessary to think in proportions instead of in mere amounts, and, all things considered, the proportions are not very much different from those one hundred years ago.

The physical achievement of a levy is not great since the saving of interest results in a diminished yield of ordinary taxation. The levy of £3000 millions that has been proposed would then have produced a saving annually of £142 millions. From this amount, however, must be deducted about £90 millions on account of losses from existing taxes which that amount of capital and the income from it would have produced. The ravages on the future yield of income and surtax and death duties are considerable. Income-tax would have been less by approximately £30 millions, super-tax by £30 millions or more, and death duties from £25 to £30 millions. Thus there would have been a loss of from £85 to £90 millions per annum, which would have had to be deducted from the figure of £142 millions. Great Britain would have had approximately from £52 to £57 millions per annum from the levy. Sir Josiah Stamp's estimates in 1923 agree with these on the whole. His estimate is from £42 to £50 millions per annum, and £70 millions per annum is the estimate of Mr. Dalton, who favours the levy.² We may safely take it that the saving would have been in the neighbourhood of £50 millions. Thus the

¹ Cf. Fisk, *English Public Finance*, p. 37 (New York, Bankers' Trust Co., 1920).

² *The Capital Levy Explained*, p. 80 (London, The Labour Publishing Co., 1923).

saving of revenue consequent on the debt repayment is £140 millions a year approximately, and the net gain after allowing for the loss in annual taxation is of the order of £50 millions or only about one-third of the actual levy. In other words, the income-tax could only be reduced by 1s. in the £. From this it may also be concluded that high rates of taxation, when the proceeds are kept within the country, are not very damaging and therefore a considerable reduction in high taxation is not very advantageous. Before the Committee on the Increase of War Wealth, Sir Richard Hopkins of the Board of Inland Revenue said that three-tenths of the War wealth levy of each £1000 millions would be paid in War stocks, three-tenths in cash and other securities, and four-tenths by instalments mainly in cash.¹ The Board, it is interesting to note, estimated the aggregate of the individual increase of wealth for the whole population of the United Kingdom to be £4180 millions, and that, if the increase in the hands of those persons whose post-War wealth did not exceed £5000 be excluded, there remains an aggregate of £2846 millions in the hands of nearly 340,000 people. In discussing a capital levy in Great Britain the crippling of direct taxation in the future has to be fully considered, because 97 per cent of the whole is paid by 3 per cent of the population. It has also been urged that to institute a capital levy to pay off debt at $3\frac{1}{2}$ per cent when the returns in industry are in ordinary times from 6 to 12 per cent is hardly worth the candle. A saving of 50 millions per annum on £3000 millions is only a saving of 1·7 per cent, and thus the net saving owing to the inroads on ordinary revenue is much smaller than is anticipated.

The root objection to a capital levy is its effect on capital and credit. As Montchrétien² pointed out over three hundred years ago, "credit is the soul of all commerce". An ex-Prime Minister, Mr. Ramsay MacDonald, is reported to have said that "if three thousand millions were taken by the State from accumulated wealth and used by the State to pay off its debt, that money would go back into the pockets of the people who now hold the debt. The moment their script is redeemed by

¹ Estimate put forward by Sir Richard Hopkins, Board of Inland Revenue. See the *Select Committee on Increase of Wealth (War)*, No. 102 of 1920. The five Memoranda of the Board of Inland Revenue are of much value.

² *Traité de l'économique politique* (1615), "Le credit est l'âme de tout commerce".

cheque, or by pounds, shillings, and pence, the money which finds its way into the pockets of the State's creditors is immediately reinvested through the banks into industry." He is also reported to have said that a new investment goes into industry at 20 shillings in the £ and not 17 shillings as a result of the capital levy. With all due deference to Mr. Ramsay MacDonald it cannot be said that he has strengthened his position by this half-told tale, although his lucid presentment of the case for change acts as a timely reminder of the need for refurbishing as far as possible our financial armoury. He does not seem to see that there is any difference between the creation of credit and the transfer of credit. Moreover, £3000 millions of cash do not exist. Traders use War debt to finance their business, and if the War Loan were handed over to Government they would be deprived of this. Thus a capital levy would involve a violent deflation of credit, and in the long run a scaling down of wages and prices. Government securities held by banks in the form of Treasury Bills, etc., would not be available for industry for the simple reason that they would cease to exist. Bank deposits would be reduced, and it would be necessary for the banks to curtail their loans. The result of this severe deflation of credit is an equally rapid fall in prices, with loss to industry and dislocation and probably unemployment. The trade of a country is carried on with the capital in the hands of citizens, and the destruction of this capital, if paid in War debt, would certainly lead to a decrease of credit in the hands of the mercantile community. If the levy is paid in other securities these would probably be kept for sale by Government, in which case they would depress the prices of all securities, or their dividends and interest would be devoted to the payment of interest on War debt.

It appears to be far better to repay debt every year out of a surplus which must be made from income and not from capital. The interest on the internal debt is not a dead loss to the community, as most of it is spent or invested in the country, and this tends to provide wages and lessen unemployment. The effect of a capital levy on London, which is still the money market of the world where large balances are held and utilised, would be great. Once commercial morality is broken by confiscation, money would not flow into the reservoir of capital from abroad, and commerce and industry would then be

permanently, or at least for a long period, affected detrimentally. There are other reasons in addition to these why a capital levy should not be introduced. One of these is that thrift is penalised. Those who have not saved go free, and what is required most of all at the present time is more and more thrift, as this is essential to prosperity. The shadow of uncertain levies discourages the accumulation of capital, and industrial expansion is hindered. If there are two brothers with £10,000 each, and one invests the amount in securities producing £500 per annum, and the other, a bachelor, buys an annuity of £1000 per annum, the man with £500 per annum pays a capital levy and not the other. The former may have pledged his securities to the banks as margin for securing trading operations, and although to some extent these securities would be replaced in the shape of bank credits, this would not be so if National Debt were tendered in payment of levy and cancelled. It is sometimes pointed out that the cost of collection would be high, and it is doubtful whether assessment would be possible except by computing from the income-tax returns. On the other hand, the Committee on the Increase of War Wealth were of opinion in regard to a levy on War wealth that, although the administration of a tax of this character would involve many difficulties, yet these were not insurmountable, and in the case of Great Britain it was proposed to carry out such a proposal as the Committee put forward. Under this scheme of a levy on War wealth only two assessments would have been necessary : on the wealth of "the hard-faced men who have done well out of the War", (1) at the outbreak of the War, and (2) at a later period. The great advantage of a War wealth levy was that it would have fallen on those from whom exceptional payments could be demanded. The proposal, however, was dropped, and the changes since the post-War year would make any such levy at the present time impossible. The inopportuneness of a levy on War wealth at the present time applies equally to that of a capital levy.

The main argument, then, against a capital levy is that the deflation of a country's balance sheet by a sum of, say, £3000 millions would mean a somewhat violent reduction in values. Prices and wages would decrease considerably, the borrowing powers of traders would be reduced owing to the loss of working capital, which gives the taxpayer about 5 per cent, while in the

hands of the public it earns a great deal more. At the present time, and for many years to come, the greatest service that a rich man can do is to save money and thus supply capital plentiful and cheap. The War debt is now part of the economic system of a country, and it is unwise when a country is settling down and paying its way that a levy on capital should be introduced. As one banker says : "It would be a case of burning your house to roast your pig, and it would be far better to reduce greatly the debt by a sinking fund and to exercise the strictest economy". A levy should be kept only for a time of extreme urgency. Immediately after the War the opportunity was let slip, because a capital levy, to be successful, requires immediate imposition after some exceptional event unlikely to recur, in order to give the investors confidence that the levy will not be made again. An easy money market is essential, and a levy should not be thought of in a period of trade depression. Those who support the idea are apt to forget that the payment of interest on internal debt is largely a problem of distribution, and the psychological effects of the levy are serious. "The greater productiveness of industry", said McCulloch in 1845, "and the greater well-being of the community are the real sinking funds which a wise Government should exert itself to build up and encourage, and this will be best done by giving all that freedom to industry that is consistent with right and justice."¹ The Committee on War Finance appointed by the American Economic Association in 1918 with regard to the proposed levy on capital concluded that "there are so many serious objections to the capital levy that we do not hesitate to report that, in our opinion, such a measure has no proper place in a finance plan for a country in the present position of the United States. As an alternative to repudiation in a country on the verge of bankruptcy something can be said for the plan. For a nation solvent and unembarrassed it possesses no attraction." In short, there is no short cut to debt redemption.

Finally, there is the difficulty of administrative technique. In the first place, as the Board of Inland Revenue has emphasised, there must be a fair measure of assent to such a levy. The Board, while stating, as we have seen, that a capital levy was practicable, was definitely of opinion that if taxpayers as a whole resented the levy, and were to raise important questions of technical and legal

¹ *Taxation and the Funding System*, p. 466 (London : Longmans, 1845).

detail, the execution of this levy would be interfered with and delayed, and the successful administration of the duty would be much endangered by the absence of a favourable atmosphere. Secondly, if it gave rise to widespread anxiety, misunderstanding, or hostility on the part of bankers so that capital values were to fluctuate considerably owing to the loss of confidence which it might entail, the levy would be exceedingly difficult to collect and probably very uncertain in its result on account of financial panic and general disorganisation. Thirdly, if the exemptions were to be lowered to reach those who own annually a small amount of capital, the difficulty in the collection would be enhanced. The Board of Inland Revenue illustrated this by showing that the number of individuals, exclusive of their dependents, who own £5000 of capital and upwards in Great Britain is approximately only half a million, while those owning between £2500 and £5000 number about 400,000, and the lower the limit the far greater the number of charges for a capital levy and therefore the greater the administrative difficulty. At the same time a capital levy is easier to collect than a War levy, because the former deals with an individual's assets at a given moment in the immediate past, as in the Estate Duty, while a War levy involves the ascertaining of the excess of one valuation at one period over the valuation of the same individual's assets some years previously. There are also other points to which the Board refers as follows : "The dynamic effects of a levy in its reactions on credit, prices, saving, and the national economy—effects that might prove of outstanding importance and might seriously prejudice revenue estimates based on static conditions—are not taken into account, as the Board feel that the appraisement of revenue gains or losses resulting therefrom lies in the field of speculation rather than of estimate". Fourthly, there is the difficulty of a guarantee against the repetition of the levy. "We consider", said the Committee on National Debt and Taxation on this score, "that any guarantee ought to be wide in its scope, applying to all capital wealth ; on the other hand, it ought to be limited in time. It would require to be made clear that the levy was emergency legislation, and that it would not be repeated at least for some years, unless there were any serious and unforeseen crisis. We think such an assurance would be of value and would help to allay apprehensions. It would be too sanguine to expect that it would altogether remove

them." These difficulties have to be weighed against the wiping out of a part of the National Debt in the event of another Great War. An opportunity for a capital levy was missed just after the War when the level of prices was high and the boom was still in operation. In the present circumstances the argument for such a levy no longer obtains.

6. Local authorities in recent years have found it expedient to borrow for public utilities and other capital undertakings, such as electricity, gas, and water-works, tramways, railways, and canals, public baths, cemeteries, harbours and docks—the result of the large extension of local governmental activity and the increase in wealth-seeking investment. These loans are usually raised by the issue of stock, a method which in recent years in Great Britain has increased in popularity. The stock is issued by Act of Parliament and is issued at a fixed price. Another method of raising loans is by the issue of mortgages for short or long periods where a local authority does not possess the power to issue stock or prefers not to do so. Occasionally large municipalities resort to this form of borrowing for a temporary purpose or pending an issue of stock. The second method has an advantage, as it is usually possible to repay the loan if interest rates fall and to borrow again at lower rates of interest. Short-period loans appeal to the small local investor who does not wish to tie up his capital in long-term investments. But these mortgages may be for a long period, and are taken up by insurance companies and banks from local authorities or Public Works Loan Commissioners whose function it is to lend to local authorities moneys raised on national credit. The disadvantage of the long-term loan is that if interest rates fall the local authority is committed to the payment of higher rates during the currency of the loan. Other methods of raising loans are the bank overdraft or the issue of bills of exchange when this is permitted by law ; the latter is frequently resorted to pending an issue of stock. The bank in the case of an overdraft usually charges interest only on the net balance in favour of the bank, the loan having the advantage of being repayable at any time according to arrangement.

The question at issue is the best method or methods to repay these loans. The principle underlying redemption is that the period of the loan should not exceed the life of the asset for which the loan was raised. The usual system of repaying such loans is

that of the sinking fund. Local authorities appropriate from the revenue of each year equal sums which will, with compound interest, be the equivalent of the total amount borrowed at the end of the period. These sums are left on deposit at a bank at a stipulated rate of interest, or they may be invested in outside securities yielding a more or less fixed amount. The annual interest on the loan is, of course, paid out of the revenue of the local authority in question. In short, interest on the entire principal of the loan is paid annually and the amount of the loan at the expiry of its currency. Another method is the annuity method of repayment by equal instalments of principal and interest each year, the payment being made in such a way as to repay the loan and interest thereon when the last instalment is paid. The burden of the loan on the taxpayer is spread equally over each year of the loan's currency. The third method, the fixed instalment method, is to repay out of annual revenue the principal by equal instalments for the entire period of the loan, interest being paid on the decreasing balance. The burden of the loan decreases year by year, and the objection to this method of repayment is that as the work on which the loan was spent proves remunerative the burden is lightening, as in the case of water or electricity works. The burden, therefore, is heavier in the early period of the loan.

It is essential in order to avoid waste and to minimise extravagance that the repayment of local debt should be regulated in accordance with general principles such as these already noted in the previous paragraph. The borrowings of local authorities must be controlled in all countries by higher authority. The advantages resulting from centralised control in the case of the United Kingdom have been numerous. In Great Britain local authorities have not always the knowledge of financial principles possessed by the Treasury or the Ministry of Health and therefore have gained by the control of the Central Government. The technique of the creation and repayment of debt varies with particular circumstances and is by no means a simple matter. Loans as in the case of the National Government have to be brought under control and cannot be issued without limit. Local loans must not exceed a certain proportion of the taxable value, must be for definite purposes, and must be redeemable within a fixed period. In Great Britain and in France centralised control has been of great value,

and in the United States also the control of local authorities has been beneficial. State borrowings have been limited by State constitutions, and the borrowings of local authorities by the State legislatures.

CHAPTER XXXVI

THE HISTORY OF PUBLIC DEBT—GREAT BRITAIN

SCOPE

1. In this and the subsequent chapter it is proposed to review some of the more important features in the history of public debts of various countries. A little history is sometimes a dangerous thing. It will, therefore, be all the more necessary to examine with care the main statistics on public debts without bewildering or distracting the inquirer regarding the broad facts that have to be understood. In the first place, the history of the British Public Debt will be reviewed with special reference to the fallacy of the sinking fund, a fallacy that is apt to appear at critical periods in other countries, notwithstanding the writings of Hamilton and Ricardo in exposing the absurdities of Pitt's sinking fund. The debt, the main legacy of the War, has grown from £706 millions before the War to £7860 millions at the present time. At the Armistice the debt was £6775 millions more than in August 1914. This is an enormous sum as compared with the wars of William III., which added £15 millions to the public debt, the wars of Anne £38 millions, the Seven Years' War £58 millions, the American War £121 millions, and the French War £602 millions. Great Britain followed the principle from 1916 that its Budget should provide for all normal expenditure and the War Debt charge—a standard then higher than that aimed at by any other belligerent. Great Britain and Australia paid from one-fourth to nearly one-third of the War expenditure by taxation. The United States paid even a higher proportion, namely one-third, a contrast with France, where the percentage is a shade under 17 per cent. A survey of the public debt of India will show the importance of productive debt, and the advantages of a productive external debt. The history of debt in France shows

the peril of overborrowing and the necessity of budgetary equilibrium for the restoration of sound financial conditions. A balanced Budget raises the price, *ceteris paribus*, of a country's securities, enhances credit, prevents inflating prices, and makes a beginning possible with reduced taxation. The experience of Japan in the Great War in preventing a large increase of debt, and in the distribution of her borrowings externally and internally, is instructive. Finally, the procedure in the United States in regard to the flotation of the large Liberty Loans and the soundness of the principles followed, not to mention the War Loan publicity campaigns, are also noteworthy.

THE BRITISH PUBLIC DEBT

2. Among the many lessons that we have learned and are learning as a result of the War, one of the most fruitful in its effects on financial recovery is the general conviction that States must free themselves from the paralysing clutch of borrowing to meet their everyday expenditure. All ordinary expenditure, including the interest charges on debt, should be met from taxation and not from loans. Only in exceptional circumstances must large borrowings take place. Countries like Great Britain and the United States realise that any other policy is extremely short-sighted. In Chapter XI. of Book II. and Chapter XXXII. of Book IV., the principles governing a country's expenditure from capital were discussed, and it is unnecessary to repeat what has been said in this connection. While signs of improvement have dawned in the financial sky of some countries, others may be said to be piling up debt and to be trembling almost on the razor-edge of disaster, and the remark of Adam Smith in this case is not irrelevant. "The progress", he said, "of the enormous debts which at present oppress, and will in the long run probably ruin, all the great nations of Europe, has been pretty uniform."¹ What precisely was a "pretty uniform" progress of economic ruin is not clear. But for borrowing or debt wars could not be carried on, and in peace it is this burden of debt that makes it sometimes difficult to carry on. Every increase of public debt means an increase in taxation at some time or other, or a decrease in the revenue available for other heads of expenditure.

¹ *The Wealth of Nations*, Book V. ch. iii.

The main features of the British public debt may be summarised briefly in the table below. The increase year by year and the interest charges are shown in the following table :

THE BRITISH NATIONAL DEBT

Year.	Event.	Debt (£ Millions)	Annual Charge, including Annuities (£ millions)	Increase of Debt over previous Year in this Table.	
				Net (£ millions)	Per Cent.
1689	Post-Revolution year . . .	1	0·04	..	..
1702	Accession of Queen Anne . . .	16	1·3	15	1500
1714	" George I. . .	54	3·3	38	237·5
1727	" George II. . .	52	2·4	-2	-3·7
1756	Seven Years' War began . . .	75	2·8	23	44·2
1763	" ended . . .	139	4·9	64	85·3
1775	American War began . . .	129	4·5	-10	-7·2
1784	" ended . . .	250	9·6	121	93·8
1793	French wars began . . .	239	9·3	-11	-4·4
1815	" ended . . .	841	32·0	602	251·9
1837	Accession of Queen Victoria . . .	788	29·0	-73	-8·5
1854	Crimean War began . . .	802	27·4	14	1·8
1857	" ended . . .	837	28·6	35	4·4
1899	Boer War began . . .	635	23·2	-202	-24·1
1903	" ended . . .	798	27·0	163	25·7
1910	Accession of George V. . .	762	21·8	-36	-4·5
1914	(1) March 31 . . .	706	24·5	-56	-7·4
	(2) Great War begins (Aug.) . . .	708	24·5	2	0·3
1915	March 31 . . .	1162	22·7	454	64·1
1916	" . . .	2190	60·2	1028	88·5
1917	" . . .	4064	127·3	1874	85·6
1918	" . . .	5921	189·9	1857	45·7
1919	" (Great War ended November 1918) . . .	7481	270·0	1560	26·3
1920	March 31 . . .	7876	332·0	395	5·3
1921	" . . .	7623	349·6	-253	-3·2
1922	" . . .	7721	332·3	98	1·3
1923	" . . .	7813	324·0	92	1·2
1924	" . . .	7708	347·3	-105	-1·3
1929	" . . .	7621	369·0	-87	-1·1
1930	" . . .	7596	355·0	-25	-0·3
1931	" . . .	7583	360·0	-13	-0·2
1934	" . . .	8030	224·0	447	5·9

The debt in 1688 consisted of temporary obligations for arrears due to the Army and for other demands connected with the Revolution. The litigation connected with the Goldsmiths' claim for reimbursements of the amount seized from them by

Charles II. in 1672 was adjudicated at £664,263, and if this is added to the temporary obligations for arrears, £384,000, the figure was over one million sterling at the time of the Revolution.¹ To the reign of William III. the methods of public borrowing now in force may be mainly traced, although the National Debt was not formally constituted until the General Fund Act was passed in 1716.² The influence of Dutch finance at this period was considerable on English finance. The Bank of England, founded in 1694, gave better financial facilities than those of the Goldsmiths, and the temporary advances by the Bank at this period are the forerunner of the Ways and Means advances of the present day. The unfunded debt was in the form of tallies, Navy bills, and Exchequer bills. Tallies were of two kinds. They were wooden sticks given as receipts for money payments³ or instruments of payment and operated as a modern cheque on a banker. In 1696 Exchequer bills took the place of tallies and were issued in even denominations of £5 and £10. They were negotiable when endorsed and they carried interest. They were received by Government in payment of all taxes except the land tax, and when received could be re-issued. In 1707 they were accepted in payment for taxes or any obligation due to Government and exchanged for ready money on demand at the Bank of England. An allowance of $4\frac{1}{2}$ per cent per annum was made at the Bank of England for circulating the bills, and the Bank advised the Exchequer as to the amount of bills which should be placed on the market.⁴

The funded debt was, in the early period of its history, in the form of annuities and perpetual loans from the Bank of England, the Bank of Ireland, the East India Company, and the South Sea Company, which advanced money in exchange for charter privileges. Reference has already been made to annuities which represent only periodical payments. The grant of a charter to a rival to the East India Company had as its consideration a loan

¹ The Goldsmiths made advances to the Crown in anticipation of the proceeds of certain taxes.

² Section 37 of the General Fund Act, 3 Geo. I. c. 7.

³ See Part II., *Public Income and Expenditure*, 366—I—1869 (H.M. Treasury Return), App. 13, p. 339; cf. Anson, *Law and Custom of the Constitution*, vol. ii. p. 310 (Oxford, 1892).

⁴ Vide *Accounts relating to the Public Income and Expenditure of Great Britain and Ireland*, 366—I—1869, App. 13, p. 512.

to the State of £2,000,000 in 1698. The amalgamation of the two Companies in 1702 led to a further loan of £1,200,000. The South Sea Company exchanged its stock for the unfunded debt of Government and paid £500,000 in addition in return for trading rights. The attempted conversion of the whole of the debt into the Company's stock and the bursting of the South Sea bubble are too well known to require elaboration.

Lottery loans¹ were first raised in the seventeenth century. The first loan of this kind drawn under sanction of public authority was in the reign of James I. for the expenses of the colonies in Virginia. From 1688 to 1755 lotteries were used to encourage contributions to Government loans. The Lottery Annuity Loans of Queen Anne's reign (1710, 1711, 1712, 1713, and 1714) are good examples. In 1755 the first lottery was issued in aid of the revenue as a source of profit by allotting among contributors an amount of stock of less value than the total sum subscribed. From 1768 lotteries were a permanent source of revenue. All the loans contracted in the American War of Independence were connected with lotteries. In 1778, for example, in connexion with the loan of £6,000,000 there were 48,000 lottery tickets. Each subscriber of £1000 received an equivalent amount of 3 per cent stock and an annuity for 30 years of £2 : 10s. on each £100, which amounted to 5½ per cent for 30 years, together with the privilege of purchasing 8 lottery tickets for an additional payment of £80. After 1784 the practice of attaching elaborate lottery schemes to loan flotations was discontinued, but until 1823 a certain percentage of the annual requirements of the Exchequer was provided from the proceeds of the sale of lottery tickets. Between 1755 and 1826 lottery loans were resorted to no less than 55 times. The net income throughout the period from lotteries (apart from loan receipts) was £12,000,000.

THE SINKING FUNDS

3. Prior to Sir Robert Walpole's sinking fund in 1716² there existed duties or taxes set aside for paying the service on particular loans, including the gradual repayment of the principal itself.

¹ *Op. cit.* App. 13, pp. 482-7.

² 3 Geo. I. c. 17. Cf. *An Inquiry concerning the Rise and Progress, the Redemption and Present State and the Management of the National Debt*, by

Such examples are the First General Mortgage Act passed in 1697, several similar Acts passed in the reign of Queen Anne, and the Aggregate Fund Act passed in 1715 in the reign of George I. The first sinking fund for the discharge of debt on a regular system dates from 1716. The credit of this belongs really to Sir Robert Walpole, but on his resignation it was completed by the administration of the Earl Stanhope. It was provided in the Act of 1716 that the surplus of certain duties and funds "shall be appropriated, reserved, and employed to and for discharging the principal and interest of such national debts and encumbrances as were incurred before the 25th December 1716, and are declared to be national debts, and are provided for by Act of Parliament, in such manner and form as shall be directed or appointed by any future Act or Acts of Parliament to be discharged therewith or out of the same, and to or for none other use, intent, or purpose whatsoever". The legal rate of interest had been reduced two years previously from 6 to 5 per cent, and Government was able to obtain the same reduction on its loans, and the savings were applied in aid of the sinking fund which was formed for the purpose of discharging debt by periodically setting aside sums to accumulate at interest. The annual receipts and issues on account of the sinking fund which are available from the earliest year of its creation show that the sinking fund was diverted from its purpose and other payments charged upon it. Previous to the period of the establishment of the Consolidated Fund in 1786 the original character of the sinking fund entirely changed. It had become the principal fund from which the public expenditure was defrayed.

In 1727 the rate of interest was reduced from 5 to 4 per cent and £400,000 was added to the sinking fund. In 1749 the rate on part of the debt was reduced to $3\frac{1}{2}$ per cent for seven years and to 3 per cent thereafter. In 1750 the interest of the balance was reduced to $3\frac{1}{2}$ per cent for five years and to 3 per cent thereafter. The operation of 1750 resulted in the saving of £600,000, which was utilised for sinking fund purposes. This system of a sinking

Robert Hamilton (Edinburgh : Oliphant, Waugh & Innes, 1814); cf. *Sinking Fund and Redemption of Public Debt* (App. 13, p. 710, Of Accounts relating to the Public Income and Expenditure, 366—I—1869), Ricardo's "Essay on the Funding System" written for the Supplement to the sixth edition of the *Encyclopaedia Britannica* and published in Ricardo's *Works* by McCulloch (London : John Murray, 1852).

fund was useless, as will be seen from the fact that between 1717 and 1788 most of the expenditure was absorbed, not in the repayment of debt, but in the payment of interest on debt and in ordinary expenditure. The total deficits in the annual Budgets were not far short of the whole sinking fund, and new debt almost equal in amount to the sinking fund was created. The following figures are of interest in this connexion :

HISTORY OF THE ENGLISH SINKING FUNDS (1717-1788)		
	£ (millions).	
Receipts	201	
Expenditure : (1) Repayment of debt	24	
(2) Payment of interest on debt	99	
(3) Ordinary expenditure	93	
	—	216
Excess of expenditure over receipts	15	
	=	=
Excess of expenditure over income (in annual Budgets)	185	
Amount of loans raised	189	
	—	—
Excess of loans over deficits	4	
	=	=

Thus the sinking fund was diverted to purposes other than what was originally intended and its inviolable application to debt redemption given up. "On the whole", writes Hamilton in his trenchant criticisms on the sinking fund, "this fund did little in time of peace, and nothing in time of war, to the discharge of the National Debt. The purpose of its inviolable application was abandoned, and the hopes entertained of its powerful efficacy entirely disappointed."

Even previous to the establishment of Pitt's sinking fund the Commissioners of Public Accounts from 1782 to 1783 pressed on the Government the necessity of forming a plan for the reduction of the debt and the creation of a fund to be invariably applied under proper direction. "This Fund", they said, "must be the surplus of the annual income above the annual expenses of the State, to be obtained and increased by the extension and improvement of the sources of revenue and by a frugal administration of the produce." Unfortunately this sound principle was not followed. The new sinking fund of 1786¹ was established through

¹ 26 Geo. III. c. 31.

the influence of Dr. Richard Price, whose scheme for a sinking fund was put forward in his *Treatise on Reversionary Annuities*, published in 1771. Price proposed the formation of a permanent Commission "acting under penalties, in such a manner as will take it out of the hands of the Treasury and form a check upon the House of Commons itself". The object underlying Pitt's fund was to set aside £1 million per annum or £250,000 quarterly out of the old surplus duties which formed the previous fund. This million sterling was to be used for the purchase of stock, and the dividends thereon were to be accumulated at compound interest until the dividends on the purchased stocks and the £1 million originally invested amounted to £4 millions. Thereafter the dividends on the £4 millions were not to be added to the sinking fund, but were to be utilised for the reduction of taxation or for any other purpose. In 1792 the principle of a true sinking fund was introduced by placing 1 per cent on all new loans issued for public purposes, *i.e.* an annual provision was made for gradual redemption in addition to interest. It was thought that by this system every loan would be automatically wiped out in 45 years at the latest. In 1798, 1799, and 1800 no provision of 1 per cent for a sinking fund was attached to the loans of these years. In 1802 the two sinking funds of 1786 and 1792 were combined, although the features of each were maintained. In 1807 Lord Henry Petty, Chancellor of the Exchequer, put forward a complex scheme which was adopted in the arrangement of the loan for that year, but, as Hamilton points out, since the Ministry which planned the scheme did not continue long in office, it was never followed after the first year. Moreover, it was not understood on account of its complexity. In 1813 Mr. Vansittart modified Pitt's sinking fund in such a way that it was restored to the state in which the proposals of 1786 and 1792 would have left it had no subsequent alteration taken place. Mr. Vansittart's main object was the final discharge of the old debt of 1786 and a continuous policy of applying a sinking fund to all loans subsequently raised in order to secure their redemption within the maximum period of 45 years. In 1817 the sinking fund of Ireland was consolidated with that of Great Britain, and in 1819 the whole question of these funds was considered by a Committee of the House of Commons. The result was that a resolution was passed to set aside £5,000,000 per annum from

income for the purpose of discharging debt. This resolution, passed by the House of Commons on 8th June 1819, was to the effect “that to provide for the exigencies of the public service, to make such progressive reduction of the National Debt as may adequately support public credit, and to afford to the country a prospect of future relief from a part of its present burdens, it is absolutely necessary that there should be a clear surplus of the income of the country above the expenditure of not less than £5,000,000 sterling”. Owing to a series of fictitious operations, one of which was borrowing from the sinking fund itself in order to show this surplus, the resolution was never actually carried out. In 1823¹ an effort was made to reconstitute the sinking fund by providing £5,000,000 a year from the consolidated fund, but this was misused in the next few years for the conversion of debt. In 1827 Lord Grenville published privately an essay, of which only the first part was printed—“An Essay on the Supposed Advantages of a Sinking Fund”. Lord Grenville enunciated three leading principles of a sinking fund: (1) its entire dependence on a surplus of revenue; (2) the consequent uselessness of all borrowed sinking funds; and (3) the impossibility of deriving benefit from a sinking fund operating in times of war or of otherwise deficient revenue. Two conditions, he believed, to be indispensable—the continued existence of a surplus and the appropriation of that surplus uninterruptedly to the reduction of debt. No sinking fund could be of any use except where the ordinary income of the State permanently exceeded its current expenditure, and “no sinking fund can truly exist except in periods of peace”. The way had been prepared by the remarkable book of Hamilton published in 1813, and by Ricardo’s *Essay on the Funding System*, 1821; and these, especially the former, more than Grenville’s essay, led to the recommendations of the House of Commons Finance Committee of 1828, which restored the idea of the sinking fund to its original and proper object. It was then decided that the sinking fund can only depend on (1) a surplus of revenue, and (2) the regular investment of this sum to be applied to the reduction of debt. It was suggested that the Chancellor of the Exchequer should aim at obtaining an annual surplus of £3 millions a year for this purpose. Goulburn, in his Budget speech of 11th July 1828,

¹ 4 Geo. IV. c. 19.

somewhat modified this proposal, and in 1829 a definite arrangement was arrived at by which one-fourth of the surplus of revenue in each year was to be issued to the National Debt Commissioners, who were empowered to buy Exchequer bills or a portion of funded or unfunded debt, whichever was advantageous. For about 40 years the principle of this arrangement was not interfered with, but the annual amount paid for the extinction of debt was far less than £3 millions, being slightly over one-third of that amount. From 1793 to 1829 it is interesting to note that there was only one year (1817) in which money was not raised by loan in order to aid the sinking fund.

In 1866 the special Acts that were on the Statute Book relating to sinking funds were repealed, but a provision was retained under which a surplus of income over expenditure was applied to the extinction of debt. This provision still survives under the name of the "Old Sinking Fund". In 1875 the "New Sinking Fund" of Sir Stafford Northcote was formed. It was an effective sinking fund, which has generally been carried on by his successors. A fixed amount was, as we have seen, annually set aside for the entire service of debt. From this the balance after meeting interest charges, terminable annuities, management, and specific sinking funds, was used as the New Sinking Fund.¹ The New Sinking Fund cannot be used for paying off Ways and Means advances. It will be seen that these funds are not sinking funds in the strictest sense of the term, since they are not definite sums annually set apart for the extinction of debt within a fixed period. The margin for the purpose of redeeming debt would itself increase as the charge for the interest fell owing to the reduction in the debt. The amount of the fixed-debt charge was originally fixed at £27,400,000 for 1875–76, £27,700,000 for 1876–1877, and £28,000,000 for every subsequent financial year. It was also provided that all perpetual or terminable annuities charged on the Consolidated Fund by any Act prior to 1875 should be paid out of the permanent annual charge. This fixed-debt charge was altered in the Finance Act of the year from time to time, as, for example, in 1887–88 it was reduced to £26 millions, in 1889–90 to £25 millions, and in 1899–1900 to £23 millions. In the pre-War year (1913–14), when it stood at £24½ millions, the

¹ *Life, Letters, and Diaries of Sir Stafford Northcote, first Earl of Iddesleigh*, by Andrew Lang, 2 vols., 1890.

New Sinking Fund was £5,228,000, or about 0·8 per cent of the total debt. After the principal of terminable annuities is added (£2,377,880), the total issue for debt redemption in that year was £7,605,880 or 1·15 per cent. From the outbreak of the War the New Sinking Fund was suspended, with the exception of £1 million applied to the redemption of drawn Exchequer Bonds. In 1922–1923 it was suspended as a temporary measure, but in the following year by the Finance Act of 1923 the fixed-debt charge of 1875 was repealed and a definite annual provision which would bring the debt within the fixed-debt charge was set up. A definite sum of £40 millions was provided for 1923–24, £45 millions for 1924–25, and £50 millions for subsequent years. The following table shows the National Debt charges, including the sinking fund, from 1923–1924, when the fixed-charge arrangement of 1875 was repealed :

THE NEW SINKING FUND, INTEREST, AND OTHER PAYMENTS
CONNECTED WITH THE NATIONAL DEBT SERVICE

	1923–24	1928–29	1930–31	1931–32	1932–33
Interest on debt funded and unfunded	258.4	255.8	251.7	252.9	253.9
Interest on terminable annuities	0.4	0.4	0.4	0.4	0.4
Interest on Treasury bills .	17.4	26.2	12.5	20.7	5.9
Interest to U.S.A. Government Loan	29.6	27.7	27.3	13.6	19.9
Management and expenses	1.5	1.4	1.3	1.9	2.1
Sinking fund . . .	40.0	57.5	66.8	32.5	26.3
Total . . .	347.3	369.0	360.0	322.0	308.5

It should be noted that during the War certain specific sinking funds were attached to loans such as the 3½ per cent Conversion Loan, the 4 per cent Victory Bonds, and the 4 per cent Funding Loan 1960–90. In regard to the 3½ per cent Conversion Loan, the Treasury must issue from the Consolidated Fund after the close of each half-year when the loan is below 90 per cent a sum equal to not less than 1 per cent of the amount of the loan outstanding at the close of that half-year, to be applied in the purchase of Conversion Loan for cancellation. Under the 4 per cent Victory Bonds and the 4 per cent Funding Loan 1960–90 the Treasury must set aside at the close of each half-year a sum equal to 2½ per cent on the nominal amount of these Bonds and Loans

created under the prospectuses of 12th June 1919 (£768,640,000), and after deducting therefrom the amount required for the payment of interest on those securities for the half-year, it must issue to the National Debt Commissioners the balance to be applied by them to sinking fund purposes in accordance with the prospectuses. In the case of Victory Bonds the sinking fund is applied to annual drawings at par. In the case of the Funding Loan it is applied to purchase and cancellation when the loan is below par, but the amount may be invested if the price is above par. Under the terms of issue of the 4 per cent Victory Bonds which were issued at 85, these are accepted at par in payment of Death Duties. War Loan can also be tendered for this purpose and purchased and held by the National Debt Commissioners from the Inland Revenue Commissioners until drawn. These additional provisions have operated in much the same way as a sinking fund. The payments to the sinking fund and on terminal annuities for ten years from 1923–24 approximate to 0·64 per cent of the total debt outstanding on the last day of March 1933. An examination of the receipts of the British sinking funds from the end of the eighteenth century up to the first quarter of the nineteenth century (1828) shows that (1) half the actual receipts of the fund were raised by loans ; (2) further debt was being incurred while the fund was accumulating ; and (3) debt was incurred at a higher rate of interest to pay off debt at a lower rate, as loans raised at the beginning of the nineteenth century carried interest at £5 : 0 : 6, whereas previous loans carried only £4 : 10s. per cent. This difference of $\frac{1}{2}$ per cent on £330 millions was equivalent to £1 $\frac{1}{2}$ millions a year. In short, debt was incurred at a higher rate of interest to pay off debt at a lower rate, which is unsound finance, and this deserves the well-merited rebuke of McCulloch, who speaks of this British sinking fund as “ this worthless compound of delusion and absurdity ”.

HAMILTON'S MAXIMS OF FINANCE

4. The absurdities of the sinking fund are not so clear to the reader of the financial history of the early part of the nineteenth century, including the parliamentary debates, as is sometimes imagined. Even during the War claims were put forward in some countries to pay off debt borrowed at a lower rate of interest from loans at a higher rate, which contained some of the fallacies

appertaining to the sinking fund. It was left to an Aberdeen Professor of Mathematics who wrote on public debt to show clearly the true principles to be followed in public finance.¹ Hamilton enunciated 12 maxims, which are as follows :

“ (1) The annual income of a nation consists of the united produce of its agriculture, manufactures, and commerce. This income is the source from which the inhabitants derive the necessaries and comforts of life ; distributed, according to their stations, in various proportions ; and from which the public revenue, necessary for internal administration, or for war, is raised.

“ (2) The portion of national income which can be appropriated to public purposes, and the possible amount of taxation, are limited ; and we are already far advanced to the utmost limit.

“ (3) The amount of the revenue raised in time of peace ought to be greater than the expense of a peace establishment, and the overplus applied for the discharge of debts contracted in former wars, or reserved as a resource for the expense of future wars.

“ (4) In time of war, taxes may be raised to a greater height than can be easily borne in peaceable times ; and the amount of the additional taxes, together with the surplus of the peace establishment, applied for defraying the expenses of the War.

“ (5) The expense of modern wars has been generally so great that the revenue raised within the year is insufficient to defray it. Hence the necessity of having recourse to the system of funding, or anticipation. The sum required to complete the public expenditure is borrowed on such terms as it can be procured for ; and taxes are imposed for the payment of the interest ; or perhaps to a greater extent, with a view to the gradual extinction of the principal.

“ (6) In every year of war where this system is adopted, the amount of the public debt is increased, and the total increase of

¹ Hamilton, *op. cit.*, especially Part III. p. 129, “ Examination of Plans for the Redemption of the National Debt and other Financial Operations ”. The Commissioners of Public Accounts 1782-83 enunciated the doctrine before Hamilton. Gallatin two decades earlier in the United States enunciated this principle in his published criticism of the American Sinking Fund which Alexander Hamilton had initiated in imitation of Pitt’s.

debt during a war depends upon its duration, and the annual excess of the expenditure above the revenue.

“ (7) In every year of peace, the excess of the revenue above the expenditure ought to be applied to the discharge of the national debt ; and the amount discharged during any period of peace depends upon the length of its continuance and the amount of the annual surplus.

“ (8) If the periods of war compared with those of peace, and the annual excess of the war expenditure compared with the annual savings during the peace establishment, be so related, that more debt is contracted in every war than is discharged in the succeeding peace, the consequence is a perpetual increase of the debt ; and the ultimate consequence must be its amount to a magnitude which the nation is unable to bear.

“ (9) The only effectual remedies to this danger are the extension of the relative length of the periods of peace ; frugality in the peace establishment ; lessening of the war expenses ; and increase of taxes, whether permanent, or levied during war.

“ (10) If the three former of these remedies be impracticable, the last affords our only resource. By increasing the war taxes, the sum required to be raised by loan is lessened. By increasing the taxes in time of peace, the sum applicable to the discharge of debt is increased. These measures may be followed to such an extent, that the savings in time of peace may be brought to an equality with the surplus expenditure in time of war, even on the supposition that the periods of their relative duration shall be the same for centuries to come that they have been for a century past.

“ (11) When taxation is carried to the extent mentioned above, the affairs of the nation will go on, under the pressure of existing burdens, but without a continual accumulation of debt, which would terminate in bankruptcy. So long as taxation is below that standard, accumulation of debt advances, and it becomes more difficult to raise taxation to the proper height. If it should ever be carried beyond that standard, a gradual discharge of the existing burdens will be obtained, and these consequences will take place in the exact degree in which taxation falls short of, or exceeds, the standard of average expenditure.

“ (12) *The excess of revenue above expenditure is the only real*

sinking fund by which the public debt can be discharged. The increase of the revenue, or the diminution of expense, is the only means by which this sinking fund can be enlarged, and its operations rendered more effectual ; and all schemes for discharging the national debt, by sinking funds operating by compound interest, or in any other manner, unless so far as they are founded upon this principle, are illusory.”¹

The last of these is the most important, but all the propositions are incontrovertible except that the first would be slightly modified to include services, and the last clause of the third, viz. on hoards, is not now adopted by financiers. Hamilton was the first to point out in the clearest possible way the fallacy underlying Pitt’s sinking fund. Undoubtedly Price’s idea that the old sinking fund was accumulating at compound interest and paying off debt by its own unaided force was to some extent correct. If, as we have seen, the fund has been invested abroad and the interest received also invested abroad, a large annual sum would have been in reality bearing compound interest and paying off national debt. In the words of Hamilton : “ When Dr. Price says that a debt of £258 millions might be discharged in 86 years, at no greater expense than an annual saving of £200,000, he overlooks the taxes imposed year after year, for the payment of interest ; a great part of which would not have been needed, if that annual sum had not been separated from the public revenue. . . . The Doctor’s plan for discharging the national debt by borrowing money at simple interest, in order to improve it at compound interest, is, we apprehend, completely delusive. He admits the absurdity of such a measure in private life, and its absurdity in national finance is exactly the same.”²

CONVERSIONS

5. The first measure of conversion in the British debt belongs to Walpole, although carried out by Stanhope, his successor as Chancellor of the Exchequer, in 1717. In 1714 the legal rate of interest for private transactions, which had been fixed at 6 per cent in the year of Restoration, was reduced to 5 per cent,³ but the greater portion of the National Debt still carried interest at 6 per cent. Borrowing at lower rates was not considered

¹ Hamilton, *National Debt*, pp. 7-11.

² *Ibid.*, pp. 139 and 141.

³ Act 12 Anne, stat. 2, c. 16.

possible, owing to the doubtful security of the throne on account of Jacobite tendencies, and the irregularity in the payment of debt. Walpole saw, however, that material advantages could be gained by conversion, and with the reduction of interest from 6 to 5 per cent a rise in the price of Stocks took place. The savings thus effected amounted to £329,000. A similar opportunity of effecting a conversion was considered in 1737, but was not supported by Walpole, who did not wish to alienate his capitalist supporters. Previous to this, much of the 5 per cent debt had been reduced to 4 per cent through the assistance of the Bank of England and the South Sea Company. Some amounts had been borrowed even at 3 per cent. In 1749,¹ when Pelham became Chancellor of the Exchequer, the holders of 4 per cent securities amounting to nearly £58 millions were given the option of interest at 4 per cent for one year, followed by $3\frac{1}{2}$ per cent for seven years (during which no reduction would take place), with a further reduction to 3 per cent after this period. Holders of Stock were given three months to make up their minds. At the end of this period £54 millions of the 4 per cents were converted, *i.e.* £39 millions. An additional three months were granted to holders of non-converted 4 per cents,² which brought in an additional £15 $\frac{1}{2}$ millions. The remaining £3 $\frac{1}{2}$ millions were redeemed at par by a new loan. This conversion of 1749 yielded an immediate saving of £272,000, increasing to £544,000 in seven years. In 1818 Mr. Vansittart converted £27 millions of Stock from 3 into $3\frac{1}{2}$ per cent in order to obtain from the holders an advance of £3 millions without adding to the capital of the debt. This form of conversion is exceedingly rare. In 1822 he converted Stock offering £105, bearing interest at 4 per cent, in exchange for £100 of 5 per cent Stock. Holders of nearly £150 millions accepted, leaving less than £3 millions of the Stock to be paid off, and the annual saving was £1,197,000. The new 4 per cent Stock was made irredeemable for seven years.³ There were other 4 per cent Stocks amounting to £76 millions, which were not secured against

¹ Act 23 Geo. II. c. 1.

² Act 23 Geo. II. c. 22. Under the latter Act three months more were allowed to the stockholders who did not convert under the previous Act, but the terms were somewhat different. The period of $3\frac{1}{2}$ per cent interest was in their case to last for five and not seven years.

³ Act 3 Geo. IV. c. 9.

redemption, and in 1824¹ a convenient opportunity was found to offer the holders of Stock in exchange 3½ per cent Stock irredeemable for five years. The offer was accepted as regards £70 millions and the remaining £6 millions were paid off, the annual saving being £381,000. In 1830 the guarantee given to the 4 per cent Stock of 1822 had expired, and the Stock stood at 102½. Mr. Goulburn decided to offer in exchange for each £100 of Stock either £100 of 3½ per cent Stock irredeemable for ten years, or £70 of a 5 per cent Stock irredeemable for forty-two years, both these options being approximately of the same value.² Over £150 millions of Stock was converted almost entirely into 3½ per cent Stock. The balance of less than £3 millions was paid off and an annual saving of £754,000 was effected. In 1844 Mr. Goulburn again converted £249 millions of Stock. At this period the funded debt consisted almost entirely of 3 and 3½ per cents, with a small amount of 5 per cent Stock created in connexion with the conversion of 1830. The holders of the 3 per cents were offered in exchange a new Stock bearing interest at 3¼ per cent for ten years, and 3 per cent for the following twenty years.³ Only £103,000 had to be paid off at par. The annual saving in interest was £622,000 for ten years, and double that amount for subsequent years. In 1853 Mr. Gladstone attempted to extinguish a small group of 3 per cents amounting to £9½ millions, which were outside the main 3 per cents.⁴ The option of exchanging £100 Stock for either £82 : 10s. of 3½ per cent Stock guaranteed for forty years, or £110 at 2½ per cent Stock guaranteed for the same period, or for Exchequer Bonds at par, did not prove successful. Only £1½ millions were converted, and the remaining £8 millions had to be paid off at par, with some loss of capital, as the current market price of the 3 per cents was less than par. This failure was due to the disturbing effects of approaching war in the Crimea. This conversion forms the nucleus of the 2½ per cent Stocks of subsequent years. In 1884 Mr. Childers made an unsuccessful attempt to convert 3 per cents amounting to £600 millions into 2¾ and 2½ per cents, both irredeemable for twenty-one years.⁵ Only £22 millions were thus converted, and even

¹ Act 5 Geo. IV. c. 24.

² Act 2 Geo. IV. c. 13.

³ Acts 7 & 8 Vict. cc. 4 and 5.

⁴ Act 16 Vict. c. 23.

⁵ Act 47 & 48 Vict. c. 23.

of this one-half was held by Government authorities. Goschen, in 1888, seized the golden opportunity for a great scheme of conversion as evidenced by the prevailing market conditions. He offered to holders of 3 per cent Stocks, which amounted to £558 millions, an exchange at par into a new Stock bearing interest at the rate of 3 per cent for the first year, $2\frac{3}{4}$ per cent for the next fourteen years, and $2\frac{1}{2}$ per cent for twenty years thereafter, i.e. until 1923, when the Stock was to be redeemable at the option of Government. Holders of the new 3 per cents had to accept this conversion or accept being paid off at par, as they were not entitled to notice. It was made optional to holders of the other Stocks, and a bonus of 5s. per cent was offered to them to forgo their right of notice.¹ The conversion of the Consols and the reduction to 3 per cent were facilitated by a commission paid to stockbrokers, bankers, agents, and solicitors. The brokerage, however, was small in comparison with the Stocks presented, namely £234,000, representing Stocks to the amount of over £312,000,000. The terms of Goschen's redemption scheme were accepted by all holders of the new 3 per cents and by the great majority of the holders of Consols and reduced 3 per cents, the amount left outstanding being only £42 millions. An Act was passed providing for the redemption or conversion of the outstanding Stock at the expiry of the statutory notice. All the funds required for further operations were raised by Treasury Bills and Exchequer Bonds, by temporary advances, and by the creation of an additional half-million of the new Stock. In the end it was necessary to pay off only £19 millions. The final result of the whole conversion was an annual saving in interest of £1,412,000, which increased to twice that amount after fourteen years. The operation resulted in a considerable saving and its simplicity had much to do with its success.

Conversions since the War are of much interest because Government borrowings were on an altogether unprecedented scale. Rates of interest during the War years were rising, and this necessitated the floating of debt which was definitely redeemable within a comparatively short time. It required also in the later stages of the War the giving of safeguards against depreciation in order to attract the large sums which were essential. With

¹ Act 51 Vict. c. 2.

rare exceptions and excluding the 4 per cent and the 5 per cent War Loans, the whole of the British internal debt floated during the War was borrowed on terms which required it to be repaid or converted by 1929 at latest. Conversions were either on account of options given in the past in prospectuses of the original loans as an additional incentive to subscribe or in response to new offers. Under an option given to subscribers to that issue in 1915, about £255 millions $2\frac{1}{2}$ per cent Consols, £137,470,000 $3\frac{1}{2}$ per cent War Loan 1925–28, £8 millions $2\frac{1}{2}$ per cent Annuities, and £1 million $2\frac{3}{4}$ per cent Annuities were converted into $4\frac{1}{2}$ per cent War Loan 1925–45. In 1917, when the 5 per cent War Loan 1929–47 and the 4 per cent War Loan 1929–47 were issued, an option was given to holders of $4\frac{1}{2}$ per cent War Loan 1925–45, 5 per cent Exchequer Bonds 1919, 1920, and 1921, and 6 per cent Exchequer Bonds 1920. In 1919 an opportunity to convert into 4 per cent Funding Loan 1960–90 and 4 per cent Victory Bonds was given to holders of $4\frac{1}{2}$ per cent War Loan 1925–45, 5 per cent Exchequer Bonds 1919, 1920, 1921, and 1922, 6 per cent Exchequer Bonds 1920, 4 per cent National War Bonds (first, second, and third series), and 5 per cent National War Bonds. This resulted in £120,617,000 being converted into Funding Loan and £72,203,000 into Victory Bonds. Further examples of the improvement in the debt position in the post-War decade could be multiplied.

The capital of the debt was of secondary importance to the rearrangement of maturing debts and to the lightening of the annual burden of interest. Between 1st April 1920 and 1st March 1926, £1583 millions of debts were cancelled and £1867 millions of debts were set up with an increase of £284 millions, but there was a decrease in annual interest of £1,191,000. It may be said that the whole policy since the War has been to convert short-dated into long-dated loans, and by 1934 Government credit had been put on a 3 per cent basis largely owing to confidence resulting from Budget equilibrium. In 1924–25 the interest on the National Debt amounted to £312,100,000, and ten years later (1933–34) this had fallen to £215,155,000. There was thus a fall in the annual interest of less than £96,945,000. Money rates also have fallen because the opportunity for using money remuneratively was greatly reduced by the contraction of international finance and trade. Following the trade depression of

1931, cheap money, it goes without saying, was the monetary expression of an economic condition which was in itself undesirable. It was an indication not of prosperity but of industrial depression, since it was due less to abundance of supply than to inadequacy of demand. The great change which has taken place in the maturities of the National Debt in the last decade may be seen from the fact that the bulk of the internal debt is now long-term debt, and thus in such a form as to give no cause for anxiety to the Treasury. The successful conversion of £2,086,977,258 of 5 per cent War Loan to 3 per cent War Loan in 1932 has already been referred to in the previous chapter on the principles of conversion. Its success may be seen from the following table :

Date of Conversion.	Amount of Loan.	Dissentients	Per cent of Dissentients.
1822 : Navy's 5's . . .	149,627,876	2,794,276	1·9
1824 : Old 4's . . .	76,248,180	6,149,245	8·0
1830 : New 4's . . .	150,790,176	2,880,915	1·9
1844 : 3½'s . . .	248,757,311	103,352	..
1888 : Consol 3's . . .	557,993,508	42,000,000	7·5*
1932 : 5% War Loan . . .	2,086,977,258	165,000,000	7·9

* Finally, £19 millions or 3 4 per cent only had to be paid off.

The central feature of British finance since 1930–31 has been the very large savings in interest on debt which amounted in 1934–35 to over £80 millions a year as compared with 1930–31, and to over £100 millions as compared with ten years ago. The following table illustrates this fact :

THE COST OF INTEREST AND MANAGEMENT OF THE NATIONAL DEBT

	£		£
1925–26 . . .	308,200,000	1930–31 . . .	293,100,000
1926–27 . . .	318,500,000	1931–32 . . .	289,400,000
1927–28 . . .	313,700,000	1932–33 . . .	265,900,000
1928–29 . . .	311,400,000	1933–34 . . .	212,900,000
1929–30 . . .	307,200,000	1934–35 . . .	211,600,000

WAR-TIME FINANCE

6. The distribution of the debt in the pre-War and post-War periods is seen in the following table :

BRITISH NATIONAL DEBT (in £ millions)

	Before the War, 31st March 1914.	At the End of the War, 31st March 1919.	On 31st March 1933.
Funded Debt	587	318	3376*
2½ per cent Conversion Loan . .	..	..	5
3 per cent Conversion Loan . .	..	..	302
4½ per cent Conversion Loan . .	..	..	375
5 per cent Conversion Loan . .	..	..	323
Terminable Annuities	30	21	12
3½ per cent Conversion Loan . .	..	..	†
3½ per cent War Stock . . . .	..	63	†
4½ per cent War Stock . . . .	..	14	†
4 and 5 per cent War Stock . .	..	2068	†
National War Bonds		1636	†
4 per cent Funding Loan (1960-90)	..	..	368
4 per cent Victory Bonds . . . .	..	..	330
Treasury Bonds . . . .	..	..	416
Exchequer Bonds	20	384	..
Savings Certificates		227	388
Other debt (including American debt)	..	1241	1061
American Loan (Anglo-French) . .		51	..
Treasury Bills	13	957	776
Temporary advances . . . .	..	455	35
Total	650	7435	7768
Other capital liabilities	56	46	216

* The Statistical Abstract for the United Kingdom (Cmd. 4489, 1934) for the first time included these as funded debt.

† Converted.

The War was financed by means of 25 votes of credit spread over the following years :

Year.	Votes.	Amount (£ millions).
1914-15	3	362
1915-16	6	1420
1916-17	7	2010
1917-18	6	3050
1918 (April to November) . .	3	1900
	25	8742

The average daily expenditure during the War was £1½ millions in 1914-15, £3¾ millions in 1915-16, £6½ millions in 1916-17, and

£7 millions in 1917–18. The percentage of loans to revenue for the year ended 31st March 1915 and the subsequent five years was as follows :

WAR FINANCE

Year ended 31st March.	Percentage of Receipts from	
	Loans.	Revenue.
1915	64	36
1916	78	22
1917	74	26
1918	74	26
1919	65	35
1920	19	81

The aggregate figures for the British financing of the War from 1st August 1914 to 16th November 1918, five days after the Armistice, were approximately £8662 millions, of which loans were £6442 and the yield of revenue £2220. Receipts from revenue were, therefore, 25 per cent of the total on an average. It is interesting to compare this with the total Australian war expenditure for the seven years ending 30th June 1922, which was £477 millions, of which £135 millions were charged against revenue (28 per cent) and £342 millions (72 per cent) against loans.

In the tables above external debt is included with the internal debt in the total figures. The external debt amounted on 31st March 1934 to £1036·5 millions at par of exchange, of which the U.S.A. Government Loan was £897·5 millions, loans from Allied Governments £134·9 millions, and the remainder, 5½ per cent twenty-year Bonds 1937, £4·1 millions. The internal debt at the same date amounted to £6908·6 millions, of which £1920 millions were in 3½ per cent War Loan, £742 millions in 3½ per cent Conversion Loan, £400·9 millions in 4 per cent Consolidated Loan, £299·7 millions in Consols, and £12 millions in Terminable Annuities Loan. The unfunded debt includes 4½ per cent Conversion Loan 1940–44, £375·4 millions, 5 per cent Conversion Loan 1944–64, £323 millions, 3 per cent Conversion Loan 1948–1953, £301·8 millions, 2½ per cent Conversion Loan 1944–49, £206·5 millions, 4 per cent Funding Loan 1960–90, £364·4 millions, and 4 per cent Victory Bonds, £326·7 millions. The remainder

of the unfunded debt was in Treasury Bonds (£384 millions), National Savings Certificates (£389 millions), Treasury Bills (£799·8 millions), and Ways and Means Advances (£44·9 millions). The figure of floating debt is still high, and is in part due to the fact that the Exchange Equalisation Fund was financed from this source. The total amount of the gross liabilities and the assets of the State on 31st March 1934 were (in millions of £) as follows: funded debt, £3374·3; estimated capital liability of terminable annuities, £12; and unfunded debt, £4558·8; a total of £7945·2 millions less Bonds tendered for Death Duties £122·9 millions, or £7822·3 millions. To this total other capital liabilities arising out of telegraphs, Unemployment Insurance Acts 1920–31, etc., account for £208·1 millions; or a gross total of £8030·4 millions. The assets include Suez Canal shares which were valued at £88·7 millions, and "other assets" including advances from votes of credits to Dominions, Allied Powers, etc., and other War assets amounting to £529·5 millions, or a total of £618·2 millions, to which the Exchequer balances at the Bank of England and Ireland (£2·6 millions) may be added. The amount of loans remaining unpaid to Great Britain on 31st March 1934 was £2297·1 millions; Colonies, £113·8 millions; Relief Loans, £29·9 millions; and other debts, £4·7 millions—or a total of £2445·5 millions.

There are one or two features regarding the loans raised during the War which require special notice. In the first place, for the first time in history Great Britain was compelled to borrow large sums abroad. The first foreign loan was issued in New York in 1915. The loan was a 5 per cent five-year loan for \$500 millions. The loan was repaid on maturity on 15th October 1920 and strengthened American confidence in British credit. Subsequently the British Government issued its own loans in New York, collateral security being provided in the form of dollar bonds which the British Government paid or borrowed from its own nationals under the Dollar Security Mobilisation Scheme. Credits were also raised through agents of the British Treasury in New York in 1917. After the entry of the United States into the War the British Government borrowed funds from the United States Government direct. Loans were also raised in Argentina, Uruguay, Chile, Spain, Switzerland, Holland, and Sweden, but these were rapidly repaid, the outstanding debt

BRITISH WAR LOANS

Issue.	Date of Issue.	Price of Issue.	Cash Receipts only, i.e paid into Bank of England on Government Account, (£ millions)
1. 3½% Loan 1925-1928 . . .	1914, Nov. 17-24	95%	332
2. 3% Exchequer Bonds 1920 .	1915, March 5-10	£95 18 1 (tender average)	48
3. 4½% War Loan 1925-45 .	1915, June 21-July 10	Par	592
4. 5% Exchequer Bonds 1920 .	1915-16, December 17-June 1	Par	238
5. 5% Exchequer Bonds 1919 .	1916, June 2-Sept. 27	Par	34
6. 5% Exchequer Bonds 1921 .	, June 2-Oct. 2	Par	62
7. 6% Exchequer Bonds 1920 .	, Oct. 2-Dec. 30	Par	161
8. 5% War Loan 1929-47 .	1917, Jan. 11-Feb. 16	95%	} 941
9. 4% War Loan 1920-42 .	, Jan. 11-Feb. 16	Par	
10. 5% Exchequer Bonds 1922 .	, Apr. 13-Sept. 22	Par	82
<i>National War Bonds:</i>			
11. 1st series . . .	1918, Oct. 1, 1917-March 31	Par	616
12. 2nd series . . .	1918, Apr. 1-Sept. 30	5% War Bonds Par 4% April-1-22 Par Apr. 23-Sept. 30, 101½%	483
13. 3rd series . . .	1919, Oct. 1, 1918-Jan. 18	5% Bonds Par 4% Bonds 101½%	494
14. 4th series . . .	1919, Feb. 1-May 31	5% Bonds Par 4% Bonds 101%	76
15. 4% Funding Loan . . .	, June 12-July 12	80%	215
16. 4% Victory Bonds . . .	, June 12-July 12	85%	217

NOTE.—The amount of issue in each case was unlimited except in the case of Nos. 1 and 2, which were limited to £350 and £50 millions respectively.

being the War debt to America. Another characteristic of this period, as will be seen from the table on the previous page, is that Consols gave way to the 5 per cent War Loan issued at the beginning of 1917. The cash subscriptions to the 5 per cent War Loan of 1917 amounted to £966 millions, and conversions of the earlier $4\frac{1}{2}$ per cent loan and Exchequer Bonds amounted to £1104 millions, making a total of £2070 millions, which at the time of its conversion in 1932 amounted to £2087 millions. A third characteristic was the principle adopted in 1915 of "continuous borrowing", when 5 per cent Exchequer Bonds were placed on sale. The fourth of this series of Exchequer Bonds, the 6 per cents, were closed at the end of December 1916 in order not to stand in the way of the 5 per cent War Loan, the biggest loan floated during the War in Great Britain. As early as April 1915 Treasury Bills in unlimited quantities were placed continuously on sale at fixed rates to all comers ($2\frac{3}{4}$ per cent for three months, $3\frac{5}{8}$ per cent for six months, and $3\frac{3}{4}$ per cent for longer maturities). A fourth characteristic was that there was the system of tax compounding in the 4 per cent loan which was introduced along with the 5 per cent loan of 1917 in order to meet the investor who demanded exemption from income tax. In the 5 per cent War Loan, the National War Bonds, and the Funding Loan a departure from the collection of income tax at source occurred, the investor being paid the whole dividend without any deduction. Interest on the 4 per cent loan was reduced to a figure which allowed for the compounding of income tax at the maximum rate prevailing. The interest on the loan was not exempt from super-tax, and for calculation purposes it was assumed that the 4 per cent interest was the net income after the deduction of income tax at the full normal rate of income tax then prevailing—5 shillings in the £.

Lastly, the floating of debt (which consists of very short obligations such as Treasury Bills which range usually from 3 to 6 months' duration and Bank of England loans) was high during and after the War. The average from March 1919 was £447 millions for advances and £958·9 millions for Treasuries. By March 1932 advances from the Bank of England were £1·8 millions, advances from Government departments £31·9 millions, and Treasury Bills £580·2 millions. The floating debt on account of its short-dated character is held mainly by banks and not by

investors. When outstanding in large amounts it becomes a very important factor in determining the value of money, and it tends to weaken the power of the Bank of England to control local money conditions. When floating debt takes the form of direct borrowing from the Bank of England, actual inflation is caused. The maximum period of inflation in Great Britain coincided with the creation of Treasury Bills of over £1200 millions with large borrowings from the Bank of England on Ways and Means advances. In the post-War period, therefore, the first step in bringing the National Debt under control was steadily to reduce the volume of the floating debt.

CHAPTER XXXVII

THE PUBLIC DEBT IN OTHER COUNTRIES

In this chapter it is proposed to illustrate from the history of debt in certain countries several principles of public debt. In the United States debt redemption and conversion have been on a scale unknown in other countries, and it is important to study the history of the American public debt from this and other points of view. In France the troubles connected with a large floating debt can be illustrated perhaps better from the history of its debt than in the case of any other country of importance. In Germany the effects of inflation on the burden of debt are noticeable. The public debt of Japan is of special importance in recent years, since much criticism has been directed against the policy of resorting to large internal loans to balance the budget. The accretions to public debt on a scale for this purpose merit study, since the policy underlying this is the very reverse from what obtains in, for example, another country in Asia—India. In India the Gladstonian principles followed for nearly a century require emphasis, as showing the advantages which accrue from a self-supporting debt which has been administered on what may be termed the old-fashioned principles of sound finance. In India and in Australia the principles underlying borrowing in a federal State are also important.

UNITED STATES OF AMERICA

1. When Alexander Hamilton was appointed by Washington in 1789 as the first Secretary of the United States Treasury he was confronted with the problem of the National Debt. In his Report on Public Credit submitted on 9th January 1790¹

¹ *Public Credit*, 9th January 1790; *Public Credit*, 16th January 1795. These two important reports rank with three others equally well known: *National*

he insisted that the foreign debt, amounting to \$11,710,000, must be paid in full, as it had been contracted under certain clear conditions. Secondly, the domestic debt, the principal of which was \$27,383,000 with accrued interest at \$13,030,000, must, notwithstanding the variety of the contracts underlying these obligations, also be paid in full without discrimination against speculative buyers of depreciated securities. In the third place, the State debts, which totalled \$18,271,786, he said, the federal authority must assume on the theory that it would contribute to a more considered arrangement of national finances, and at the same time it would certainly contribute to national unity. The Funding Act, which provided for three loans to take up these different classes of indebtedness, was passed on 4th August 1790 and at once stabilised the finances of the country. The principles which Alexander Hamilton stood for are as important to-day and as beneficial as they were in the year in which the Funding Act was passed. To carry out these principles he had to meet with stubborn anti-Federalist opposition. He stood for federal stability, and thought in terms of Federal authority as did Madison of State authority and Jefferson in terms of individual welfare. "The only enemy", he said, "republicanism has to fear in this country is in the spirit of faction and anarchy." He organised the Treasury and carried through the scheme of funding which proved so beneficial notwithstanding the criticism from some later authorities. Adams, for example, held the view that, "It is a serious criticism upon the financier who funds a series of floating obligations or who converts a funded debt that any reasonable policy of debt payment should thereafter be embarrassed by the terms of the contract in the newly created obligations. The conversion of a debt should be regarded as an opportunity for bringing the debt under control so far as ultimate payment is

Bank, 13th December 1790; *Establishment of a Mint*, 28th January 1791; and *Encouragement and Protection of Manufactures*, 5th December 1791. (*Vide* Lodge's edition, New York, 1885, vol. ii., "Finance and Taxation"; vol. iii., "Finance, Taxation, and Commercial Relations". Cf. *American State Papers*, vol. i.) "It will be the truest policy of the United States to give all possible energy to public credit," said Hamilton, "by a firm adherence to its strictest maxims, and yet, to avoid the ills of an excessive employment of it, by true economy and system in the public expenditure, by steadily cultivating peace, and by using sincere, efficient, and persevering endeavours to diminish present debts, prevent the accumulation of new, and secure the discharge within a reasonable period of such as it may be at any time a matter of necessity to contract."

concerned. The funding scheme of Alexander Hamilton and the refunding programme of Secretary Sherman are alike open to criticism from this point of view."¹ The manner in which the public debt of the United States has been reduced from time to time notwithstanding the greater increase in population and wealth over long periods is seen in the following table :

NATIONAL DEBT OF THE UNITED STATES

	Debt (\$ millions).		Debt (\$ millions).
1790	75	1905	1132
1796	84	1910	1147
1812 (War, 1812-14).	45	1913	1193
1816	127	1914	1188
1819	96	1915	1191
1825	84	1916	1225
1832	24	1917 (War, 6th April)	2977
1835	Debt extinguished	1918 (Armistice, 11th Nov.)	12,244
1846 (War, 1846-47).	16	1919	25,482
1852	63	1920	24,298
1857	28	1921	23,976
1860	65	1922	22,964
1861	91	1923	22,350
1862	514	1925	20,516
1863 Civil War	1120	1929	16,931
1864	1816	1931	16,801
1865	2678	1932	19,487
1875	2156	1933	22,539
1885	1578	1934	27,053
1890	1122	1935	31,087 *
1895	1097	1936	34,239 *
1900	1263		

* Provisional figures

During the administration of Gallatin the debt was reduced in spite of the Louisiana purchase. The public debt fell in 1812 to \$45,200,000. The debt leapt up during the war of 1812-15, when no less than 92 per cent of the war expenditure (\$64,300,000 out of \$70,000,000) was met from loans, a percentage even less satisfactory than that of France in the recent Great War. As a consequence of the war the public debt rose to \$127,334,000 in 1816. During the years 1816 and 1817 much of the debt was paid off, but bad years followed and expensive long-term loans were floated. After 1825, however, the finances were in so favourable a condition that a reduction in the size of the debt was successfully made. By 1833 the debt was so reduced that it was

¹ Adams, *Finance*, p. 555; cf. his *Public Debts*, p. 226.

redeemed by the year 1835. The increase in the Civil War, 1861–1865, is clearly seen from the table above. The fiscal year 1862–1863 was the darkest in American history. Bonds were unsaleable even at a discount at home, and abroad American credit was at lowest ebb. The lessons learned from the issue of inconvertible paper have not been forgotten. In 1865 the debt had reached a level that was not touched until the United States entered the War in 1917. The maximum was reached in August 1865, \$2758 millions, as against \$2977 millions in 1917. Of \$2758 millions the greater portion was in the form of floating debt (\$1276 millions) and inconvertible paper (\$460 millions). The funded debt amounted to only \$1110 millions. A sinking fund law was passed in 1862, but it did not become operative until 1866, as there was no real surplus. In 1868 the temporary debt was paid, and henceforth repayment and conversion were possible. The rates of interest fell towards the end of the century. In 1890 the debt was \$1122 millions, and in 1895 the debt was \$1097 millions. In the first year of the present century it was \$1263 millions, in 1910 \$1147 millions, and in 1916, the year previous to America's entry into the War, \$1125 millions. The great increases from 1918 to 1920 are brought out in the statement above, for in the fiscal years ending 30th June 1917, 1918, and 1919 the respective additions to the debt were \$1,760,473,000, \$9,268,010,000, and \$13,238,405,000. On 31st August 1919 the high-water mark of \$26,596,700,000 was reached, a level not exceeded before 1934. Almost all the War-time indebtedness is in the form of bonds and is held by United States citizens. Immediately after the War the Treasury, following a great tradition, set about reducing the total debt, and for some years this averaged about \$900 millions, so that by 30th June 1930 the National Debt had been lowered to \$16,185,308,000. The Secretary of the Treasury in his Report in the year 1926 estimated that, at the then rate of retirement, the domestic debt representing War expenditure and excluding that part of the debt that covers the loans to the Allies, will have been discharged by 1944. If these debts were to be repaid over a 62-year period, *i.e.* at the same rate as was provided for in the Funding Agreements with debtor nations, the interest charges would have amounted to over \$16,126 millions, as compared with \$4042 millions if the debt has been discharged by 1944, and the total payments would have

aggregated \$24,839 millions against \$12,755 millions. By a reduction of about 70 per cent of the period of maturity of the domestic debt it was calculated that there would be a reduction in the total payments of approximately 50 per cent. While the Federal debt may be repaid within a fairly short period, State and local debts which are productive on the whole and therefore analogous to the capital invested in corporations in so far as they yield their own interest need not be repaid, at any rate within a period less than the duration of the work or works in which the capital is invested. The prospect of this rate of decreasing the annual debt was greatly interfered with by the crisis of 1930-31. Debt reduction, of course, depends upon the Government's expenditure and upon its tax policy. The following table shows the composition of the United States public debt at the end of the fiscal year 1934. The large increase in the debt during and since the War is striking. The interest payments may be compared in size with the pre-War issues.

PUBLIC DEBT OF THE UNITED STATES ON 30TH JUNE 1934

Interest-bearing debt—		\$
Bonds :		
Pre-War issues		831,350,370
Liberty loans		6,345,774,250
Post-War issues		9,332,732,350
Treasury notes		6,931,550,900
Certificates of indebtedness		1,635,045,000
Treasury saving certificates		1,404,035,000
Total interest-bearing debt outstanding . . .		26,480,487,870
Matured debt on which interest has ceased . . .		54,266,830
Outstanding debt bearing no interest		<u>518,386,714</u>
Total gross debt		<u>27,053,141,414</u>
Interest paid during fiscal year		756,617,127

The total debt is less than that of France and also of Great Britain, although the United States is the wealthiest of the three Powers.¹

The loan policy of the United States Government during the years 1917 and 1918 and subsequently is as noteworthy as it was successful. In the first place the flotation of the four Liberty Loans in 1917 and 1918 and the Victory Liberty Loan of 1919 is a permanent wonder to many students of American finance. The total amount issued, according to the Annual Report of the

¹ For the wealth of these three countries see Table XXVI.

Secretary of the Treasury, was nearly \$21,433 millions, and on 30th June 1922 the amount outstanding was \$17,087 millions. The success of the fourth Liberty Loan in October 1918 ($4\frac{1}{4}$ per cent Bonds of 1933-38), when \$6965 millions were issued, was the greatest financial achievement in the history of any country. It not only reflected the strength of the United States financially, but also the wonderful War Loan organisation that was perfected by the Central Liberty Loan Committee in each of the 12 Federal Reserve Districts. The leading financial, industrial, commercial, and professional men were on each Central Committee. These committees met daily and had also the assistance of women. Similarly cities and villages had their committees, and if the daily returns showed that cities or villages were behind in their allotted quotas speakers of repute were sent to rouse the lethargic in this campaign of education. It is estimated that at the end of the War at least 20 millions, and perhaps even 25 millions, out of a total population of 106 millions were holders of Liberty Bonds. Every effort was made to draw the borrowings from actual savings and to get the securities into the hands of investors. In June 1921, according to reports from banks doing over 40 per cent of the commercial banking of the country, only a very small proportion of the long-term loans, Victory notes, and Treasury certificates were pledged with these banks as security. Secondly, the use of Government paper money was avoided and bank credit used instead. Inflation, which is difficult in war to avoid, was kept to a minimum by (1) the restriction of credit to essentials; (2) the inculcating of thrift either in the form of payment to the Liberty Loans from current savings or in the eschewing of luxuries of all kinds by taxation. Thirty-two per cent was, moreover, paid from taxation according to the data given in the Annual Report of the Secretary to the Treasury for 1920. The net War expenditure to 30th June 1920 was \$33,455 millions, and the excess of the annual tax revenue over the normal tax revenue was \$10,703 millions. An independent authority estimates these figures at \$35,428 millions and \$11,819 millions respectively. Thus one-third of the cost of the War was obtained from revenue and two-thirds from loans, a striking contrast with many leading European countries, and this at a time when Federal revenues were completely changed by the introduction of income and profits taxation and a Federal estate tax which made the tax

system direct and progressive in place of, as an American writer terms it, indirect and regressive. Thirdly, the use of terminable securities with maturities not exceeding thirty years issued every six months at rates just high enough to attract savings was markedly successful. Conversion privileges were also not overlooked. In order that these large Bond issues should not be too much of a strain on the market, they were preceded by almost monthly issues of floating debt which were to be taken up by Liberty Bonds or payment of taxes. To reduce still further tightness of credit by the concentration of funds in Government Treasuries, and to compensate banks for their trouble, banks subscribing to Government loans held their subscriptions as a credit on Government account until the funds were called for by Government. This was known as "payment by credit". Lastly, a sinking fund of $2\frac{1}{2}$ per cent of the aggregate total of the loans outstanding on 1st July 1920, less the amount invested in foreign Government securities, was established by an Act of Congress dated 3rd March 1919. This was a guarantee which increased the confidence of the investing public and is an interesting example for some other countries to follow.

FRANCE

2. Before the War the French debt was the largest in the world. Just after the War, in 1920, it was also the largest, but after the devaluation of the franc in 1926 the National Debt of both Great Britain and of the United States expressed in sterling or dollars was larger. The burden of the debt has already been referred to in Chapter XXXIII. The debt problem of France is not a new one. The troubles of some of the post-War years, such as 1926, may be, with reason, compared with those of the Revolution when assignats were issued from the printing-press too freely, a flight from the currency having its effect in both cases on the National Debt. The distrust which was universally felt in the ability of the Government to fulfil its monetary obligations and to restore the credit of the country abroad is typical in both cases, and is illustrated in the first table on the following page.¹ In

¹ Cf. von Sybel, vol. iv. p. 334, quoted by Kemmerer on Money (New York, The Macmillan Co., 1935, p. 193): "Money, which was formerly sought by every one, was now passed from hand to hand like a piece of hot iron: every man endeavoured to get rid of it, in any legal way, for a tolerably secure possession."

1926 the "camouflaged" loans from the Bank of France and the "camouflaged" inflation sowed the seeds of lasting evils and left a very embarrassing task to successive Governments. Budget disequilibrium and a large floating debt bring about uncertainty and lack of confidence in a country's finances, and this was true of France in 1926 as it was in later years when the Budget deficits were unusually large. Thus the Budget deficit in 1932 was over 6 milliards of francs (£67 millions), and in 1933 6·9 milliards of francs (£82 millions).¹ There was also a large floating debt in both years which was mainly responsible for the difficulties which arose with the onset of the world trade depression.

Year	Assignats in Terms of Sterling.	Year	Francs in Terms of Sterling
1789	26·55	1919	31·80
1790	26·55	1920	52·75
1791, January	27·72	1921	51·92
" July	28·99	1922	54·63
1792, January	35·03	1923	75·73
" July	41·35	1924	85·27
1793, January	49·46	1925	103·02
" July	109·67	1926, end of April	162
1794, January	63·06	" middle of May	154
" July	74·19	" May (third week)	177
1795, January	140·14		

The increase in the French Debt, as compared with that of earlier periods, is seen from the following tables :

FRENCH NATIONAL DEBT

Year.	Total Debt (millions)	Annual Debt Charges (millions)
	Francs.	Francs.
1713	1,200	..
1763	2,750	..
1793	800	..
1800	725	..
1814 (1st April)	1,275	75
1816	3,500	..
1830	5,182	223
1848	6,500	1
1852	6,639	262
1868	12,383	382

¹ Average rate of the year. If the par value were taken, the figures would be £49 and £55 millions respectively.

FRENCH NATIONAL DEBT—*Continued*

Year	Total Debt (millions)	Annual Debt Charges (millions)
	Francs.	Francs.
1876 (1st January)	19,900	750
1883	27,401	1,121
1887 (1st January)	24,675	850
1893	30,313	1,039
1895	25,975	825
1900	27,150	..
1903	30,799	924
1913	32,976	966
1920	177,872	11,000
1921	222,204	10,469
1922	242,108	11,850
1923	250,084	10,796
1924	270,708	10,796
1925 (30th April)	286,175	14,797
1930	482,179	14,007
1931	480,822	13,195
1932	459,746	9,168

On the 31st of March 1932 the distribution of the debt between fixed or funded debt and floating debt was as follows :

FRENCH PUBLIC DEBT

		31st March 1932 (millions)	31st August 1934 * (millions)
Internal debt—			
i. Fixed debt		243,846·2	261,891
ii. Floating debt		40,469	53,929
	Total . . .	284,315·2	315,820
External debt (Inter-governmental and commercial)		175,430·4	196,011
	Grand Total . . .	459,745·6	511,831
Sterling at par (Fr. 124·21 = £1) in millions . . .		= £3,701	= £4,121
Sterling at average rate of the year in millions . . .		= £5,154 †	= £6,671 †
Service of debt Fr. millions		9,168·4 ‡	10,816·5 ‡

* Subject to revision.

† Average rate of exchange for 1932 and 1934 was 89·21 and 76·72 francs per £ respectively.

‡ Expenditure of the general budget only. Debt service effected by the Amortisation Fund (*e.g.* in 1932 Francs 11,744·5 millions) is excluded.

It is not possible here to comment at length on these tables. The main lessons of the French public debt, the increase in debt

due to extravagance and wars, and the direction of financial policy under a series of very able ministers, are well described in the five volumes of the *Histoire financière de la France depuis 1775*¹ by Marcel Marion of the Collège de France. Even before the Revolution Louis XV. (1715–74) increased the State debt in spite of the assistance of such financiers as Turgot (appointed by the King Controller-General and Minister of Finance in 1774) and Necker (who was Director-General of Finance in 1788, and the author in 1781 of the well-known *Compte rendu présenté au roi* and *L'Administration des finances de la France* (1784), which is still consulted to-day. Cambon, the Finance Minister under the Revolution, consolidated the debt. All the debt was inscribed in a *grand livre* of the public debt which was taken to be conclusive evidence of the claim. Until February 1796 interest was paid in assignats at their face value. But the assignats had been printed in such quantities—the total issues being 400 millions of francs in 1789, rising to over 3750 millions of francs in 1790, and to no less a figure than 45,500 millions by 1796—that they became worthless early in 1796. The salaries of public officials even when raised thirty times had still no purchasing power. A judge, we are told, in the district of the Seine died of hunger. Officials went on strike and the public administration was completely disorganised. The actual value of the notes was ultimately less than the cost of manufacture, and thus there was no advantage in printing them. The engraving plates and printing presses where they were printed were publicly destroyed in 1796. Barter had to be resorted to in place of a money economy. In April 1796 the new land notes which had taken the place of the previous assignats did not circulate and were not worth by the end of that year more than 20 per cent of their face value. These notes, however, being accepted by Government at a definite value in payment for land led to a curious result. The Government sold wooded land for the price of a few trees on it and the demonetisation of these land notes became accordingly inevitable. The lesson from this depreciation of the currency on interest payments of the public debt is obvious, and recalls the violent fluctuations in 1925–26 when the franc depreciated in terms of sterling in much the same degree as did assignats in sterling in the years just previous to 1796. After this date interest was paid in

¹ Paris, 1914–28.

assignats at the rate of 10 francs for each franc of interest due. Assignats were called in in July 1796. Interest was thereafter paid one-fourth in cash and three-fourths in bills on the national domains. In 1797 it was proposed to pay one-third of the service of the debt, or 86 million francs, and to pay off the capital itself of the remaining two-thirds in national domains. The third retained or the “consolidated third” was declared to be “exempt from all stoppage, present or future”. The other two-thirds were paid off at the rate of 20 times the annual interest in notes receivable for national domains. As the creditors were required to buy lands, these two-thirds constituted a loss to the poor who could not afford to purchase lands. Under Napoleon (1804–18) the finances were set in order by two great men, Gaudin, who is the father of the modern system of French financial administration, and Mollien, Minister of the Treasury in 1806. In his *Mémoires relatifs à la Révolution, à l'Empire et à la Restauration*¹ Gaudin gives the secret which guided him : “The spirit of order is the first desideratum in financial administration ; it applies to everything and embraces both men and things”. The country had never an abler, a more resourceful and yet more prudent and uniformly efficient Minister of the Treasury than Mollien. Both these financiers served Napoleon after “the brow of the Emperor broke through the thin mask of the consul”, because, as Goethe said, “under his orders men were sure of accomplishing their ends”. As proof of this one need only compare the National Debt in 1814 with that of Great Britain, and also the subsequent history of the French debt during the nineteenth century. The smallness of the debt in 1814 on the fall of the Empire as compared with that of Great Britain shows to a great extent the very able administration of financiers like Gaudin and Mollien. During the revolution of August 1830 the indemnity levied on France, the payment to the army of occupation, and the payment to compensate the old nobility increased the debt. Some of the debt was converted in this period as in 1824 in 4½ per cents and in 3 per cents. Five per cent Stock in the third decade of the nineteenth century was no longer the order of the day. The French debt increased during the Orleanist dynasty and under the Second Empire. During the reign of Napoleon III. short wars, such as the Crimean War, the Italian

War, and the Chinese War, took place, and in this period also large sums were spent on public works which necessitated large borrowings. In 1852 the 5 per cent *rentes* were converted into 4½ per cents, and in 1862 the 4½ per cents were reduced to 3 per cents. The first conversion resulted in a saving of interest, while the second added largely to the capital of the debt. The war of 1870–71 added 9 milliard francs to the debt and increased the annual debt charge threefold. Nearly half of this increase in debt was due to the payment of an indemnity of 5 milliard francs (or £200 millions) to Germany. Loans to the extent of 8496 million francs were created between August 1870 and July 1872, and for this the amount received was 6803 million francs, and the annual interest amounted to 400 million francs. Under the Third Republic the public debt of France was again increased, especially by Freycinet, whose scheme for public works, including railways, was very ambitious. Railways, telegraphs and telephones, highways and waterways were constructed from direct loans or subventions from the State or by State guarantees of company issues. In 1883 the conversion of 5 per cent *rentes* into 4½ per cents yielded an annual saving of 34 million francs without any increase in capital. Further conversions were carried out in 1887, 1894, and 1902.

In the pre-War year the debt had increased to 34 milliards of francs. The increase from 3·5 milliard francs at the close of the revolutionary period to 34 milliard francs in 1913 may be estimated to be due to two-thirds from war and one-third on account of the construction of public works such as railroads, canals, docks, sanitary works, and the building of schools.

When the Great War began, the French Government did not obtain the sinews of war from taxes. Before the outbreak of hostilities French finance was abnormal. The Budget did not balance, and above all the system of taxation was much out of date. The income-tax, which had been voted a few days before the outbreak of war,¹ was not put into operation until 1916.² When the income-tax, War profits tax,³ and the military War tax⁴

¹ Law of 15th July 1914.

² Came into effect from 1st January 1916. This was supplemented by the law of 31st July 1917.

³ Law of 1st July 1916.

⁴ Paid by those exempt from military service, and levied as an income-tax (law of 30th December 1916).

were introduced, they were weakly applied, and the receipts from taxation were insufficient for the War and post-War Budget. The laws of December 1916 and 1917 did indeed increase taxation, but not on a scale like that in Great Britain or the United States.¹

It is interesting to see how this war expenditure was met. A reference should be made to the table below, where the statistics of consolidated debts, floating debt, foreign credits, and bank advances are given.

FRANCE'S RECEIPTS, 1914-1919

		Milliards (thousand million) Frances.	Per Cent
Ordinary receipts—			
Taxes, Government monopolies and enterprises	31	16	
Extraordinary receipts (Loans)—			
(a) Internal debt—			
Consolidated debt	53	28	
Other internal debt—			
(a) Short-term Bonds and Treasury Bonds . .	49	26	
(b) Bank of France and Bank of Algeria advances	25	13	39
(b) External debt—			
Foreign credits	33	17	
Loans	160	84	
Grand total	<u>191</u>	<u>100</u>	

From this table it will be seen that the ordinary receipts from taxes, Government monopolies and enterprises were only 16 per

¹ The general income-tax was increased by the laws of 30th December 1916, 31st July 1917, and 29th June 1918; the War profits tax by the laws of 30th December 1916 and 31st July 1917. The inheritance tax was increased by the law of 31st December 1917. Several assimilated taxes and the securities tax were increased by the law of 30th December 1916. Indirect taxes on alcohol, sugar, light alcoholic beverages, chicory and coffee, vinegar, matches and tobacco (Government monopolies) were increased in regard to matches by the laws of October 1917 and May 1919, and tobacco by laws of 30th December 1916 and January 1918 and May 1919. Postal, telegraph, and telephone rates were increased by the law of 30th December 1916. To the category of new taxes belong the consumption taxes on colonial produce, mineral waters, patent medicines, and amusements (law of 30th December 1916), the tax on commercial payments and luxuries (law of 31st December 1917 and 28th June 1918), and the special tax on goods shipped into and from the country under special licenses (decree of 15th June and law of 29th September 1917). In spite of these increases in existing taxes and the imposition of new taxes, the tax revenue was quite insufficient.

cent, the remaining 84 per cent having been obtained from loans. The proportion of borrowings to taxation in the case of France is very much higher than in the case of Great Britain or America. The floating debt (including advances of the Bank of France and the Bank of Algeria, which may be regarded as in the nature of floating debt) shows the large proportion of this debt relatively to the consolidated debt. The advances from the Bank of France have been much reduced by the revaluation of the gold bullion in virtue of the Monetary Law of 25th June 1928.

The War was financed through the advances of the Banks of Issue, short- and long-term National Defence Bonds, and foreign securities. The Government procured its resources mainly by short-term debt and floating debt. Long-term National Defence Bonds were raised in February 1915, and were to have a currency of ten years, the rate of interest being 5 per cent. In 1917 a new type of Bond was issued, known as "Obligations de la Défense Nationale", which were to mature at the end of five years. They were in reality redeemable at the end of the first year. There were four State loans issued during the War and several others after the Armistice. The Four Consolidating Loans of the National Defence were floated in 1915, 1916, 1917, and 1918. The post-Armistice loans of long-term nature were floated in 1920, 1925, and 1927. The first consolidated debt formed a part of the short-term debt in 1915. An unlimited loan was issued in the form of *rentes perpétuelles*, i.e. annuities redeemable at Government option by repayment of the capital sum.¹ The interest was 5 per cent, and the issue price 88 francs. They were not to be redeemed before 31st January 1931. The nominal amount subscribed was 15 milliard francs, and the amount realised 13 milliard francs, of which nearly half was paid in cash. In September 1916 a similar loan was authorised at 87·5 francs. This loan also was irredeemable before 31st January 1931. The nominal capital subscribed was 11½ milliard francs, and the amount realised 10 milliard francs, of which more than half was in cash. In October² 1917 a third loan, not redeemable before 1st January 1943, was issued. The rate of interest was 4 per cent, and the issue price 68·6 francs. As in the case of two previous loans, there was no fixed date of maturity. The amount subscribed was nearly 15 milliards, and the amount realised 10

¹ Law of 16th November 1915.

² Law of 26th October 1917.

milliard francs, more than half of which was in cash. The fourth and last Consolidated Loan during the War was issued at 4 per cent, and the issue price of this was 70·8 francs. The redemption was not to take place before 1st January 1944. This loan was a great success, the nominal capital subscribed being 30½ milliard francs, and the amount realised being almost 22 milliard francs. The payments in cash, however, were only one-third (7 milliard francs), the payment in Treasury bills being 13 milliard francs. This fourth loan was thus a consolidating loan to a greater extent than its predecessors. The combined result of the four great National Defence Loans was that 55 milliard francs were obtained, representing a nominal subscribed capital of 72 milliard francs and an annual interest charge of 3 milliard francs.

Notwithstanding these loans the position showed that there was the necessity of curtailing both the short-term and the floating debt which had increased from the outbreak of war. The subscriptions to the short-term National Defence Bonds ("Bons de la Défense Nationale") amounted to nearly 30 milliard francs. The issue of these bonds was authorised by a decree of 13th September 1914. The interest was payable in advance at 4 per cent for the three months' issue, and at 5 per cent for the six months' and one year issues. The ordinary Treasury bills which carried a lower rate of interest were not subscribed for until 1918, when two ministerial decisions increased the interest on them to 3 per cent for those running from one to less than two months, 3·5 per cent for those running from two to less than three months, 4·5 per cent for those running from three months to less than one year, and 5 per cent for those running from one year. In 1919, owing to these provisions, the subscriptions to the ordinary Treasury bills increased to more than 500 million francs.

Advances made by the Bank of France and the Bank of Algeria were 24,600 million francs in the case of the Bank of France, and 395 million francs in the case of the Bank of Algeria, or a total of 24,995 million francs between 1914 and April 1919. These advances were made at the rate of 1 per cent interest for the period of the duration of the War and one year following, and 3 per cent including the amount required for gradual repayment thereafter. The first advance was made in accordance with a law passed shortly after the outbreak of hostilities, which ratified a clause in the convention concluded with the Bank of France on

11th November 1911, whereby the Bank of France bound itself to advance a sum of 2900 million francs to the Government in the event of a mobilisation. The amount of the advance was increased to 6 milliards by a convention concluded on 21st December 1914 and ratified by the law of 26th December 1914. This was increased to 9 milliards in 1915 (law of July 1915), 12 and 15 milliards in 1917 (laws of 16th February and 4th October 1918), and 21 milliards in 1918 (law of 7th June), 24 and 27 milliards in 1919 (laws of 5th March and 17th July). Similar conventions were concluded with the Bank of Algeria from 6th September 1915, when the advance was increased from a maximum of 200 millions to 300 millions and then to 400 millions (law of 8th October 1918).

The Government of France, in addition to long-term debt and short-term debt in National Defence Bonds, and Treasury bills, and floating debt in the form of Treasury bills and National Defence bonds as well as bank advances, obtained foreign loans which constitute part of the consolidated debt of the country and a small part of the floating debt. This debt is divided into two distinct categories : (1) the inter-governmental loans and (2) the commercial debt (loans raised in Great Britain, the United States, together with certain bank credits abroad). At the end of the first quarter of 1919 the Treasury bills discounted by the British Treasury amounted to 11,484 million francs, while those accepted by the Bank of England amounted to 1639 million francs. The United States loan operations included the issue of ordinary Treasury bills, a Franco-British loan made in 1915 at 5 per cent, the proportion of France being 1243 million francs, an advance of 10 million dollars made by a group of American banks at $7\frac{1}{2}$ per cent, which amounted to 518 million francs, a credit of 427 million francs from loans of French cities (Paris, Lyons, Marseilles, Bordeaux), and lastly, advances made by the United States Government at 4 per cent, totalling 12,710 million francs at the beginning of 1919. By 31st March 1932 the commercial debt was 5256·3 million francs, the remainder of the foreign debt (170,174·1 millions) being War debt owed to the United States and Great Britain.

The great financial difficulties in 1925 and the first half of 1926 were due to the fact that when the short-term loans matured, both bonds and obligations were presented for payment, and in consequence the Government was forced to borrow heavily from

the Bank of France. The increase in the debt in recent years, especially in the floating debt, is noticeable. This floating debt is largely the consequence of unbalanced Budgets which in the years immediately following 1931 amounted, as we have seen, to very large sums. The amortisation of the debt is carried out by means of the Budget and also by the Autonomous Fund, which receives and cancels long- and short-term securities in payment of Succession Duties and taxes on the first transfer of property. There has been an increase in debt due to the necessity of consolidating (as in 1927) the short-term debt as it matures, and to the insufficiency of revenue to meet public expenditures. Public debt also increased owing to issues for financing reconstruction which were not covered by cash payments or deliveries in kind under the Dawes Plan. The War damage was approximately estimated at 85·8 milliards of francs, and up to 1st January 1928 75·9 milliards were paid. The balance, approximately 10 milliards, was in 1928 still to be paid. Owing to lack of Budget balance the repayment of debt has not been effected in such a way as was anticipated when the Autonomous Fund was founded on 1st October 1926. At the time of the crisis at the end of July 1935 the public debt, including life annuities, was costing the State 25 milliards of francs per annum, which is 60 per cent of the Budget of 42 milliards, excluding the so-called "Treasury Budget" of nearly 20 milliards which contained a good deal of recurrent expenditure. The French public-debt problem, in short, is closely linked up, as in other countries, with the budgetary problem.

GERMANY

3. The public debt of Germany is of interest in view of the lightness of the debt burden consequent on inflation, and also because of the methods taken to indemnify to some extent those holders of Government Loan before the depreciation of the mark. The comparative lightness of the debt burden has already been dealt with in Chapter XXXIII. The public debt and the debt service per head of population are comparatively low. The internal debt, however, since 1931 has increased remarkably, as will be seen from the following table. The increase in the floating debt has been accompanied by a decrease in the external debt.

THE PUBLIC DEBT OF GERMANY *

(In millions of marks)

Year	Internal Debt			External Debt	Total
	Funded Debt	Floating Debt	Total		
1913-14	4,918	240	5,158	.	5,158
1918-19	92,396	64,056	156,452	..	156,452
1921-22 (31st March)	80,600	281,500	362,100	..	362,100
1929-30	7,622 4	1,899 0	9,521 4	853 7	10,375 1
1930-31	7,619 0	1,165 1	8,784 1	3,305 5	12,089 6
1931-32	7,724 3	1,193 4	8,917 7	3,219 6	12,137 3
1932-33	7,775 3	1,514 4	9,289 7	3,041 6	12,331 3
1933-34	8,415 8	1,931 4	10,347 2	2,059 9	12,407 1

* The figures given do not include other debts prior to the stabilisation or reparation liabilities.

The debt service does not include the interest and redemption on the Dawes and the Young loans, which approximately amount to 90 million marks per annum. Owing to the severe inflation, the service of all debts in paper marks due by the Reich and the Länder was discontinued in February 1924.¹ The funded debt for the year ended 31st March 1922 amounted to 80,600 million paper marks and the floating debt to 281,500 million paper marks. In July 1925 most of the old loans were converted into a new "loan liquidation debt" at rates varying according to the nature and year of issue of the old debt. The basic rate was 25 gold marks to 1000 marks of the old nominal amount. Until the reparation liabilities were paid the new securities were not to yield interest or to be amortised. Those who were able to prove that they were owners of their securities before July 1920, or that they had acquired them before July 1923 in consequence of a legal obligation to invest in trustee stock, had the right to take part in yearly drawings. Any one with a nominal loan liquidation debt up to 12,500 reichsmarks might participate with the full amount of his stock. Above this figure he was able to benefit from one-half of the next 25,000 reichsmarks, one-third of the following 25,000 reichsmarks, and one-fourth of the remainder. This portion of the "loan liquidation debt", *i.e.* carrying rights of this nature, was to be redeemed within thirty years from 1926. The amount drawn was to be paid in cash at the end of the draw-

¹ In regard to this hyperinflation see Kemmerer, *Money* (New York: The Macmillan Co., 1935), ch. xiii. "Germany's Experience with Inflation, 1914-1923."

ing year at five times the nominal value of the new securities, *i.e.* generally at five times 2·5 per cent or 12·5 per cent of the old nominal amount plus 4·5 per cent interest running from 1st July 1926 to the end of the year in which the drawing took place. The Budget must include yearly allocations to a sinking fund which, after deduction of the amounts necessary for the yearly drawings, must be sufficient when invested for the total redemption of the debt in thirty years. This yearly allocation was calculated at 6 per cent and was estimated at 240 million reichsmarks. A certain sum was set aside in the Budget for annual cash payments to necessitous German holders of drawing rights actually living in Germany. They were entitled to receive special preferential annuities up to 80 per cent of the nominal amount of the drawing rights, but subject to a maximum of 800 reichsmarks for one person. This was increased to 1000 reichsmarks if the creditor renounces his or her drawing rights, and to 1200 reichsmarks if the creditor was sixty years of age at the date of renunciation. Social and scientific institutions holding drawing rights received special relief annuities for fifteen years, the total amount of which was limited annually to 10,000 reichsmarks. While these preferential and relief annuities were enjoyed, participation in the yearly drawings ceased. Owing to the financial difficulties of 1930 and 1934, payments abroad, except on the Dawes and the Young loans, were for a time withheld, as the export surplus had, through a policy of inflation, almost if not entirely disappeared. The plan followed for the pre-stabilisation of debts is of considerable interest as illustrative of the way in which the evil effects of inflation were in some degree got over.

JAPAN

4. The public debt of Japan is of importance because of the policy which has been followed in recent years to meet deficits in the Budget regularly by loan. There has been a deficit during the last decade without exception, and since March 1933 the deficit in the Budget has been large, as will be seen from the table on next page.

The continuance of heavy borrowing for the purpose of meeting Budget deficits year after year has a prejudicial effect on a country's credit, and the country has to borrow at higher rates

BUDGET DEFICITS

The surplus of expenditure over receipts (excluding loans)
(In millions of Yen)

Year	Amount	Year	Amount
1924-25	149.8	1930-31	89.0
1925-26	-2.5	1931-32	105.2
1926-27	102.8	1932-33	618.6
1927-28	241.5	1933-34	705.9
1928-29	283.2	1934-35	965.0
1929-30	200.6	1935-36	857.8

of interest than would otherwise have been necessary. The deficit of 857.8 millions of yen is the equivalent of £87,900,000¹ as compared with 965 millions of yen or £98,800,000¹ in the previous year. Japan has resorted to large internal loans in order to balance the Budget. This has the effect of raising the internal price-level, which is followed by inflation and further depreciation of the yen in terms of gold. It is often argued that the Japanese money markets are able to absorb large internal loans by showing that the yen has been in recent years stable and there has been no flight of capital abroad. The net service on all Japanese foreign debts cost only £8 millions for 1935-36 if an allowance is made for the proportion of these loans that are now held by Japanese nationals. The increase in the debt in recent years as compared with 1913-14 (the pre-War year) will be seen from the following table :

THE PUBLIC DEBT OF JAPAN

(In millions of Yen)

Year.	Internal Debt.			External * Debt.	Total.
	Funded Debt	Floating Debt	Total.		
1913-14	1,054.6	..	1,054.6	1,529.5	2,584.1
1919-20	1,482.4	..	1,482.4	1,311.2	2,793.6
1923-24	2,576.2	..	2,576.2	1,621.4	4,197.6
1929-30	..	..	4,512.6	1,446.8	5,959.4
1930-31	4,476.8	198.5	4,675.3	1,479.0	6,154.3
1931-32	4,715.0	224.0	4,939.0	1,472.6	6,411.6
1932-33	5,663.8	320.3	5,984.1	1,390.4	7,374.5
1933-34	6,724.4	543.6	7,268.0	1,414.6	8,682.6
1934-35	..	..	7,687.5	1,402.9	9,090.4

* Foreign debt is shown at par. The floating debt represents Rice Purchase Notes and Treasury Bills.

¹ At par rate figures would be £50,800,000 and £56,800,000 respectively.

The increase in floating debt as well as consolidated debt in the last few years has been noticeable, while foreign debt has slightly diminished.

INDIA

5. The debt of India is of importance because of its unique character in that 20 per cent only is deadweight debt. The remainder is interest-bearing debt. It, therefore, compares more than favourably with the debt position of almost every other country of the world. The interest-yielding assets of the State together with the additional net profits derived from commercial departments are sufficient to pay almost the whole of the interest on the total public debt. The annual interest on the non-productive debt was gradually reduced until in 1916 it amounted only to Rs.3 crores (£2·2 millions). On the other hand, railways and irrigation works which had been financed from the productive debt yielded in that year a return of Rs.23 crores (£17·3 millions), which left a margin of Rs.9 crores (£6·7 millions) of clear profit to the country after meeting the interest charges on the entire debt. This progressive reduction was due to the fact that in most years it was possible to finance a portion of India's productive works from revenue surpluses, which resulted in an increase of productive debt and an equivalent decrease in the ordinary or non-productive debt. Had it not been for India's War contribution of £100 millions, of which £16,720,000 remained outstanding in 1933–34, the ordinary debt would have been completely wiped out in 1917. The increase in the deadweight debt apart from the War contribution is due to (1) the outlay on the buildings of the new capital at Delhi costing Rs.14·5 crores (£10,900,000), and (2) the occasional revenue deficits which since 1919 have been financed from borrowings. The Gladstonian or orthodox principles underlying the public debt have been applied rigorously by India, with the result that to-day she can borrow in the London money market as cheaply as almost the British Government itself. Another feature of the debt has been the conversion in recent years of short-term debt into long-term debt so that the Government is free from any worry over maturities. Nevertheless, as already pointed out elsewhere, steps were taken in 1924 to provide Rs.4 crores per annum and such additional sum as is equal to one-eightieth of any excess shown in the total

of the debt outstanding on the 31st March of the preceding year over the total outstanding on the 31st March 1923. This was continued up to the year 1932–33, unchanged except that with effect from 1930–31 the rate of exchange for converting the sterling debt was taken at 1s. 6d. instead of 1s. 4d. The scheme was temporarily suspended in 1933–34 and a lump provision of Rs.3 crores was made in each of the years 1933–34 and 1934–35. This amount was used to reduce the debt or to decrease the amount required for capital expenditure. It is in effect a quasi-sinking fund.

The following tables show the public debt of India and its composition at the present time :

I. THE PUBLIC DEBT OF INDIA *

Year ending 31st March.	Debt	Debt Charges.	Increase of Debt over previous Year in the Table	
			Net Amount	Per cent
1845	43,50	2,01		
1857 (year of the Mutiny)	59,44	2,53	15,96	36·7
1862 (over 70 years ago)	107,51	6,62	48,05	80·8
1872 („ 60 „)	115,87	7,69	8,36	7·7
1882 („ 50 „)	166,92	6,75	51,05	44·1
1892 („ 40 „)	222,26	10,10	55,34	33·2
1902 („ 30 „)	339,35	11,16	117,09	52·7
1912 („ 20 „)	454,72	14,83	115,37	34·0
1914 (pre-War year)	551,29	15,19	96,57	21·2
1919 (end of War)	806,20 †	26,95	254,91	46·2
1922 (over 10 years ago)	820,11	35,97	13,91	1·7
	1,213,63	59,89	393,52	47·1
1932	1,211,84	59,14	– 1,79	– 0·1
1934	1,223,97	52,96	12,13	1·0

* See Table XX., App.

† Estimated.

The figures of debt previous to 1914 are not compiled strictly on the same basis as after 1914. The figures from 1914 comprise the total funded and unfunded debt including Post Office savings banks deposits, cash certificates, balances of provident and allied funds. They include also the capital value of railway terminable annuities.

In recent years steps were taken to popularise through Government loans, Post Office cash certificates and Post Office savings banks the investment habit, and this met with success. The movement towards saving in this form began with the War and has continued in spite of the trade depression. The Post Office cash certificates increased to Rs.63,72 lakhs in 1933–34—a record level—as compared with Rs.55,64 lakhs in 1932–33, Rs.44,58 lakhs

in 1931–32, and Rs.888 lakhs in 1917–18, when these were originally introduced. The increase from 1917–18 and that during the trade depression 1930–35 were remarkable. Similarly the net deposits in the Post Office savings banks reached the record figure

II. INTEREST-BEARING OBLIGATIONS OF THE GOVERNMENT OF INDIA

	On 31st March (Rs Crores) *		
	1914	1924	1934
I. In India—			
Rupee loans	145.69	358.81	435.17
Treasury bills . . . .	..	51.77	59.24
Other obligations .			
Post Office savings banks . .	23.17	24.79	52.32
Cash certificates . . .	.	8.42	63.72
Balances of provident and allied funds	10.93	39.00	82.14
Depreciation and reserve funds, provincial balances, etc.	..	4.17	19.78
Total internal . .	179.79	486.96	712.37
II. In England—			
Loans, War contribution, railway terminable annuities, and other obligations	371.50 †	432.04	511.60
III Grand total . .	551.29	919.00	1223.97
IV. Interest-yielding assets held against the above	452.72 ‡	663.58	977.67
V. Percentage of interest-bearing obligations in India	33	53	58
Percentage of interest-bearing obligations in England	67	47	42
VI. Percentage of interest-yielding assets to total	100 88	100 72	100 80

* 1 Crore = 10 million rupees = £750,000.

† For the year 1913–14 the conversion of sterling debt into rupee debt is at the rate of Re.1 = Is. 4d. For other years the rate is Re.1 = Is. 6d.

‡ Includes railways, telegraphs, and irrigation, but excludes capital lent to Provinces and Indian States. Comparative figures for 1924 and 1934 to that of 1914 are approximately Rs 557 crores and Rs.780 crores.

of Rs.892 lakhs in 1933–34 in spite of the interest rate being reduced to two and a half per cent from three per cent which had been in force for twenty-eight years. The Finance Member in his Budget speech for 1933–34 said, “The proceeds of the gold which have been sold have only to a limited extent been balanced by the purchase of consumable commodities. A great portion has

undoubtedly been invested. The increased demand for Government securities affords general evidence of this, and that the process has been widespread and not confined to the richer classes can be very clearly seen from the figures of Post Office cash certificates and saving bank deposits. These figures therefore clearly show that proceeds of gold sales have been converted into investments by the poorer classes, and although the Indian habit of accumulating reserves of gold has stood the country in good stead in the present crisis, I feel forced to regard it as a beneficial advance that the exceptionally high price of gold in rupees should have started a process of exchanging barren gold reserves for interest-bearing Government securities as a form of investment. If only the process is kept in proper channels, and the people of India are not misled, as the people of the United States were in the post-War boom, to putting their savings into widely speculative investments, the result must in the long run be of great benefit to India."

An important issue in a federal constitution has been decided recently in the New Government of India Act 1935 in regard to loans. The Federation can borrow on the revenues of India within such limits as may from time to time be fixed by Act of the Federal Legislature. Borrowing by the Units is upon the security of the revenues of a province, but the Units may not without the consent of the Federation borrow outside India nor without this consent raise any loan if there is still outstanding any part of a loan made to the Provinces by the Federation or by the Governor-General-in-Council or in respect of which a guarantee has been given by the Federation or by the Governor-General-in-Council. This puts great power in the Federal Ministry which might refuse a Province a loan or insist upon unreasonable terms and thus assume the control of the general policy of a Province. It is provided, therefore, in the Act that the ultimate decision whether consent has been unreasonably withheld in any instance should rest with the Governor-General-in-Council in his discretion.¹

AUSTRALIA AND NEW ZEALAND

6. The extremely large *per capita* public debt of Australia and New Zealand has been referred to in Chapter XXXIII. Not only

¹ Government of India Act 1935, Section 163 (25 Geo. V.).

is the public debt in these countries high but the proportion of the debt held abroad is also high. In recent years there has been a slight decrease in the proportion of debt held abroad in the case of Australia. On the 30th June 1934 the Commonwealth public debt amounted to £393·1 millions, which included a War loan from Great Britain of £79·7 millions, which by a funding arrangement would have been extinguished about 1956 by annual payments of 6 per cent, of which 1·8 per cent is for reduction of principal. Since 1931-32 the payment has been suspended. In addition to this the indebtedness of the States amounted to £829·5 millions. Of the total of £1222·6 millions or £183 per head, £629·3 millions were held in Australia, £547·3 millions in Great Britain, and £46·0 millions in the United States, or a total of 48 per cent held abroad. A greater part of the debt has been devoted to railways and tramways, water supply and sewerage works, land settlement, harbours, roads and bridges, construction of post offices, telegraphs and telephones, and for public buildings. But the debt is not in a real sense productive as is the Indian debt, since many of the works to which the capital has been devoted do not produce their own interest. The State railways, for example, are run at a loss. In Australia it is the taxpayer who bears the burden of the uneconomic working of railways, while it is the private investor in Great Britain. The capital has gone into the form of fixed capital which, although not strictly productive, is nevertheless necessary for the development of the country. Similarly in the case of New Zealand the debt on the 31st March 1934 was £302·8 millions, of which £163·8 millions (or 54 per cent) were held abroad.

As in India the Federal Government has concatenated the borrowings of the Units as well as its own borrowings by what is known as a Loan Council. This was essential in order to preserve at home and especially abroad the credit of Australia as a whole. Under the Surplus Revenue Act 1910 the Commonwealth Government paid to each State 25 shillings per head of the population as estimated by the Commonwealth Statistician at 31st December in each year. Acute differences between the State and the Commonwealth had existed before the passing of this Act. The Commonwealth proposed a bill which was introduced in June 1926 to surrender the land tax, estate duties, entertainment tax, and 40 per cent of the income tax on both

individuals and companies. The Commonwealth Government showed that the total amount of taxation to be surrendered by the Commonwealth was greater than the *per capita* payments which were to be terminated. The Bill was not passed until March 1927, and general opposition to the measure was responsible for new proposals which were put forward in June of that year. The States Grants Act 1927 abolished the *per capita* payments from 30th June 1927. In 1929 the Commonwealth, in accordance with a Commonwealth Referendum, took over all State debts existing on 30th June 1927, and pays £7,584,912 a year for 58 years towards the interest charges and is making substantial contributions towards a sinking fund to extinguish existing debts in 58 years and future debts in 53 years. The Commonwealth or Federal Government arranges all future borrowing for both Commonwealth and States through a Loan Council consisting of representatives of the Commonwealth and a representative of each State. The Loan Council thus exercises an effective and in many ways a very salutary control over the borrowings of the State Governments. The advantages of this system are obvious, since the system of taxation is not disturbed and the Commonwealth cannot in future become solely dependent upon customs and excise. The States gain in the immediate future, especially in regard to the settlement of their debts as existing at the time when the new scheme came into force. It has well been said that it is the most satisfactory readjustment of the relations between the Federal authority and the States since the Federation came into force in 1900. It has immeasurably strengthened Australia as a borrower of capital in the London money market as well as in Australia itself.

Steps were taken in 1931 by all the Governments in Australia when the crisis of that year affected the whole world and the prices of Australian produce fell to such an extent that the income of the Governments, which was £650 millions in 1927–28, fell to £450 millions in 1931–32. Measures were taken to prevent default. The Premiers' Conference adopted a plan which made the burden fall as equally as possible on every person, and no section was left in a privileged position. The plan was accepted on the understanding that all parts would be put into operation simultaneously. All Government expenditure was reduced by 20 per cent, including salaries and pensions whether fixed by

statute or otherwise. Government internal debts (but not external debts) were converted on the basis of a $2\frac{1}{2}$ per cent reduction of interest. Taxes were increased to provide additional revenue. Bank and savings bank rates of interest on deposit and advances were reduced and relief was given in respect of private mortgages. Conversion applications of internal bond-holders totalled £510 millions, while in the absence of notification of dissent £31 millions were automatically converted. Dissentients amounted to less than 3 per cent, viz. only about £16 millions. The Budget of 1933–34 had anticipated a deficit of a little over £1 million, while the final account showed a surplus of £1,302,000, and in the Budget for 1934–35 remissions of taxation and further restorations of cuts and grants to aid as well as a substantial grant for defence were made. When the internal situation had been successfully overcome, as indicated by the fact that the yield on Commonwealth stocks in Australia fell from over $6\frac{1}{4}$ per cent to less than $3\frac{1}{4}$ per cent in three years and the credit of Australia abroad was thereby enhanced by its courageous action, its sound financial policy, its fidelity to obligations, and the careful management of the national resources, conversion operations on foreign loans began. In 1933, £109,849,000 were converted in London, which resulted in an annual saving of £1,827,000 in interest and £456,000 on exchange. In the immediately succeeding years, with low interest rates prevailing in London, further conversions took place. Thus in February 1934, £21,636,550 of stock was converted into a $3\frac{1}{2}$ per cent stock, redeemable in 1954–59. It was issued at 97, and towards the end of the same year it stood at 102. From a financial point of view these steps taken are of importance, as Australia had not the advantage which India had of being able to export continuously from hoards between September 1931 and 1935 gold of the value of £180 millions.

BOOK V

FINANCIAL ADMINISTRATION

CHAPTER XXXVIII

THE PREPARATION OF THE BUDGET

THE SCOPE OF THE BUDGET

1. AN important branch of the science of public finance is financial administration, which is concerned with the collection, the preservation, and the distribution of public funds. It deals with the co-ordinating of public revenues with public expenditures ; the management of credit operations of Government and the custody of public funds usually through a central bank ; and generally with the control of all financial affairs of the State. When Adam Smith published *The Wealth of Nations* budgetism had not developed and the word “ budget ” does not even occur in his great treatise.¹ It was only coming into fashion. In 1803 the expression was adopted in French financial nomenclature as a substitute for estimates and expenditures. It has spread to all countries of importance, and in the present century it is regarded as a comprehensive term including the financial operations of the State as prepared by the executive, as legalised by the legislature, and as carried out by the executive in the form given to it during the voting of the Budget. It was only in the nineteenth century that the real significance of the Budget as the whole problem of financing the Government was realised, owing to the growth of the functions of the State in all directions, the establishment of parliamentary or popular control in public finance almost universally, the necessity of check in financial administration to prevent fraud and waste and to secure the highest possible results from public expenditures, and the growth in credit operations which has resulted in the creation of central banks as the bankers of

¹ There is, however, an anonymous pamphlet dated 1764 entitled *The Budget —Inscribed to the Man who thinks himself Minister.* Set down to David Hartley (Higgs Bibliography, 1935, number 3230). “ Budget ” is treated as a familiar word. For derivation see French Dictionary ; cf. Maurice Block, vol. 1. 260, para. 2, *Dictionnaire de la politique*, ed. 1873.

Government in various countries. The Budget is now the financial programme prepared by the chief executive and is far more than an estimate of income and expenditure for a definite period, usually a year. It is not merely a plan of public revenue and expenditure placed before the legislature on behalf of the ministry for approval, but it has been extended to mean both the entire condition of the national finances as disclosed in the ministerial statement placed before the legislature and the orderly administration of the financial affairs of the Government. Budgetism is at the root of all sound administration. The great principle underlying it is its domination by the executive government. It not only gives an account of the year's "housekeeping" and of the year to come so far as the State is concerned, but it is the basis of control of the financial affairs of the State regarded as a household. It sets into motion a continuous chain of events of great importance in the everyday work of government. In the first place there is the preparation of the Budget, the estimates of revenue and expenditure, and of the financial condition of the Treasury before and after the Budget proposals are put into execution. The second step is the passing of Acts of the legislature such as revenue or supply and appropriation Acts or of votes sanctioning the items of expenditure and granting the funds to meet it. The third stage is the opening of accounts, which in turn is followed by audit, and audit by reports on the expenditure to the legislature. There is, in short, a continuous process going on in all well-financed countries. It is perhaps unnecessary to point out that the Government in its financial administration differs from that of a private corporation. Government keeps down its expenses by careful financial administration in order to diminish its income, to diminish the amount to be taken from the pockets of the taxpayers. A corporation, on the other hand, keeps down its expenses in order to increase its income. The accounting system, therefore, of a Government is not to show profits as in the case of a business concern, but to furnish all the information required to the legislature as well as to Government itself in order that a balanced relation between income and expenditure may be maintained. Where, however, Governments undertake public utilities special problems do arise, and a system of commercial accounting, particularly when as in the case of railways or post-offices these undertakings are conducted on a

self-supporting or profit-making basis, should be adopted. This does not, however, apply to the majority of Government departments, as these are not self-supporting and do not exist for the purpose of making profits. If public utilities were included in the general Budget the figures would be swollen, and it is desirable as a general rule to separate the accounts of public undertakings from the general Budget. The system of commercial accounting when applied to all branches of the administration has proved to be both complicated and expensive and to necessitate a considerable degree of more or less arbitrary estimates such as the rental value of State-owned buildings. After the War cost accounting was introduced in many branches of British military expenditure, but in accordance with a decision taken in July 1925 it was discontinued in all except operative establishments such as bakeries, electrical departments, and laundries. The net results from the operations of public undertakings or the appropriations required to meet their deficits should be included in the general Budget, the concerns having their own independent budgets in the case of large concerns such as railways, as this makes it possible to manage these more or less on commercial lines. At the same time, however, Treasury and Parliamentary control must not be reduced.

Financial control in the United Kingdom is older than in any other country and the budgetary system is more perfect than elsewhere. The right of financial control by the legislature dates back to the reign of King John, and in the seventeenth century there was the long struggle between the Parliament and the Stuart kings, a struggle which was settled for all time in the Bill of Rights, 1688, when Parliament was given the right to levy taxes and to authorise expenditures. Just a century later the principle of Parliamentary control in finance spread over Europe and to the United States of America. The raising of revenues and the direction of expenditures by the popular assembly may be said to have begun in France and other countries of Europe, with certain exceptions, at the time of the French Revolution of 1789. The principle that the Budget should be formulated by the executive became firmly established in Europe in the first half of the nineteenth century, and in the United States in the earlier part of the twentieth century.

The Budget, then, in its usual sense is an approved plan of

income and expenditure for a fixed period of time, usually a year, a plan which is the basis of the national finances. It was originally a Gallic word which first came into use in England about 1760. It is derived from the old French word *bouquette*, the diminutive of *bouge*, a leather bag or wallet which was in use in England as early as the fifteenth century. It was the sack or wallet, the fore-runner of the present-day satchel, from which the Chancellor of the Exchequer on behalf of the Government takes out his plan or financial statement, or, in other words, he opens the Budget for the approval of the House of Commons. A Budget does not give a complete picture of the financial condition of a country, although it is a very good index of a nation's finances. It does not give the total assets and liabilities of the State, but only the receipts and payments of a Government within the year to which the Budget refers. It does not show the cost of government in a country, since there may be many subordinate local governments, and in a Federal Government, such as the United States, Canada, Australia, India, Switzerland, and Germany, law and custom determine the demarcation of government among various authorities. The cost of government, therefore, in a country like Italy where under the Fascist régime sanitary and social services only are left to local governments, cannot be compared with the cost of government, for example, in the Federal Budget of the United States, where there are forty-eight states with large cities, urban and rural districts, each having their own financial system.

There was no complete statement of the annual public income and expenditure of the United Kingdom from 1714 to 1822, although for some time after 1688 the public accounts were kept with accuracy and care. Sinclair, writing in 1804 in his *History of the Public Revenue*,¹ pointed out that "Since the reign of Queen Anne, the national accounts are far from being distinguished for their regularity or precision ; no complete statement has ever been made up of the total Income and Expenditure of the country". The practice of making and publishing an annual balance-sheet of public income and expenditure did not take place until the recommendation of the Select Committee on Public Accounts in 1822 in their Report to Parliament was carried out. The first balance-sheet of the Public Income and Expenditure was for the year ended 5th January 1823, and the

¹ 3rd edition, 1804, vol. ii. p. 58.

annual Finance Accounts have contained this information from that year. No *balanced* account, therefore, of the Public Income and Expenditure was made prior to 1822, although there is much detailed information in the annual Finance Accounts (the publication of which began in 1802) and in the yearly and quarterly revenue accounts of the Treasury, which go back for many centuries. In an official return in 1816 it was stated that "owing to the confused state in which the public accounts were kept previous to 1800, no accurate view of the income and expenditure previous to that date could be made out". For a century following 1688 the financial returns showed that the produce of every particular tax, appropriated by law to the discharge of a particular head of expenditure, was kept under a separate head of account. In 1785, for example, under Customs alone, when the Commissioners of Public Accounts recommended "the formation of one Fund, into which shall flow every stream of the public revenue, and from whence shall issue the supply for every public service", resulting in the establishment of the Consolidated Fund in 1787, there were as many as seventy-four distinct accounts. In 1786 the Commissioners of Public Accounts reported that "they adopted as a principle of public prudence, as well as benefit, that every duty should pass from the subject into the Exchequer without delay. It should not be in the power of a receiver to retain or divert any part of it under any pretence whatever", a principle that required the payment of all money whether the revenue of the year or the proceeds of loans to be credited to the Exchequer in the first instance. This forms what is called the Consolidated Fund, and the Comptroller of the Exchequer will not make issues from this fund except by the authority of Parliament. This important principle was not fully carried out until 1854. Till that year the expenses of the revenue departments, including the Post Office, were met out of the revenue collected, and these were never voted by Parliament. The net revenue only reached the Exchequer.¹ One of the leading principles in the years

¹ The proceeds of taxes are collected by the revenue departments, which are under the absolute authority of the Treasury, which means the Government. It is sometimes pointed out that the Exchequer control in regard to these could be evaded, as that control is effective only in preventing money from leaving the Exchequer. It does not secure that the proceeds of taxes or loans must be paid into the Exchequer. Critics have sometimes pointed out that the Chancellor of the Exchequer could direct the revenue-collecting departments to transfer money direct from the revenue accounts at the Bank of England,

preceding the passage of the Exchequer and Audit Department Act of 1866, "An Act to consolidate the duties of the Exchequer and Audit departments, to regulate the Receipts, Custody and Issue of Public Moneys and to provide for the Audit of the Accounts thereof", was that the gross public revenues should be paid into the Exchequer and all public expenditures met by payments from the Exchequer. Since 1848 it has been the practice to combine with the authority to issue money from the Consolidated Fund, power to borrow temporarily any sum up to the whole amount to be issued. This enables the Government to meet any voted expenditure of the year before it has received any revenue at all.

The conception of the Budget, in short, as the central instrument of financial control is of comparatively recent date. Popular assemblies were in their early struggles more concerned with taxation or revenue than with expenditure. Gradually they have come to control both. It was only in 1832 that there was initiated the first Appropriation Audit. Until that year Parliament did without an independent audit for any service, and without an audit for all services till 1866. The need for a rigid appropriation of public money is recognised to be essential, and if Parliament wishes to exercise a minute control over the administration, the subdivision of public expenditure into many separate votes is equally essential. Such a division supplies, as it were, a map of the whole field of the administration. It was thus gradually realised that the only reliable method of securing due appropriation of public money was not by the prior control of the Exchequer but by the extension of the appropriation audit to all votes. Parliamentary control has grown to mean not only the general veto on the aggregate of Government expenditure but a detailed veto on the expenditure involved by each section of Government activity separately. From the constitutional point of view the same independence is required of the important official—the Comptroller and Auditor-General—in the audit of the Public Accounts as he has in regard to Exchequer receipts and issues. A Comptroller-General of the Exchequer was appointed in 1831, but this office was abolished in 1866 when the where they are kept, to the account of the Paymaster-General without passing through the Exchequer at all. This criticism of the constitutional machinery of the British financial administration may be admitted, but this would be to depart from all normal procedure, and it never takes place.

office of Comptroller and Auditor-General was created. This official is appointed by letters patent under the Great Seal, and he cannot be removed except upon an address from both Houses of Parliament.

THE EXCHEQUER AND THE TREASURY

2. The Exchequer¹ must not be confused with the Treasury. Both are State departments and both have a long and interesting history. The Exchequer was a Norman institution and its name is derived from the Low Latin term *scaccarium*, a chess-board, from the chequered cloth or table much like a chess-board at which the Exchequer sat and on which accounts were rendered. As a name of a Government department dealing with accounts it was in its earlier history associated with the abacus, by means of which such accounts were kept. This contrivance was almost universal before the introduction of Arabic numerals, which did not come into common use in England until the sixteenth century.² In England the department was named originally "The Tallies",³ from the notched sticks or tallies which were the

¹ The *Dialogus de Scaccario*, written in 1177, describes minutely the proceedings of the Exchequer. It was written by Richard Fitz Neal, Bishop of London and formerly Lord Treasurer of the Exchequer during the time of Henry II. (1154-89). The book was meant as a manual of instruction for the clerks who were learning their business in the Exchequer rather than for the general public. It describes the procedure of the Exchequer, its constitution, its writs and its rolls, the various sources of the royal income, the collection of the debts due to the king, the treatment of his debtors, the chess-board, and the counters, the tallies, the scales for weighing the specie, and even the melting-pot. At this period the Exchequer consisted of two parts—the Upper and the Lower Exchequer, or the Court of Account and the Court of Receipt. What was found to be due in the Upper had to be paid into the Lower.

² The Exchequer numerals were a corruption of the old Roman figures and were not abolished until 1834. Under the provisions of the Act (4 Geo. II. c. 26) passed in 1731, English and common letters and figures were substituted for Latin, French, or any other language in all judicial work. In 1733 (6 Geo. II. c. 6) it was enacted that the Act of 1731 should not extend to the Exchequer. "The Roman numerals, uncouth, obscure and inconvenient as they are, and inapplicable to the commonest purposes of arithmetical calculation, were the usual formulas of abbreviation in the Norman period, and were consequently employed at the Exchequer, though the Exchequer is probably the only establishment in the civilised world that still retains them" (*Report of the Commission to enquire into the Manner in which Public Money is Received and Paid—Parliamentary Paper No. 313, 1831*).

³ The Exchequer tallies were of two kinds: (1) Tallies of Sol and (2) Tallies of Pro. Tallies of Sol were vouchers acknowledging the receipt of money into the Exchequer. They derived their name from the first word, *solutum* (the

primitive means of account-keeping (abolished only in 1826), and the name Exchequer was probably only introduced later in the reign of Henry I. When the sheriffs paid into the Exchequer at Easter the dues, they received as a receipt a tally, the counterfoil of which was retained at the Exchequer, and when they appeared again before the Exchequer at Michaelmas they paid the remainder of the annual dues, presenting the tally which represented payment already made together with the remainder in cash. Counters were placed on the squares of the Exchequer table representing the actual payments of the sheriff, while on the other side the amount for which he was liable was placed upon the squares, and it was thus easy to see at a glance how far the sheriff had fulfilled his obligations or not. In Tudor times, it is said, pen-and-ink dots took the place of counters and were used for the last time in 1676.¹ The Exchequer in Edward I.'s reign was a court of law and an administrative department. In its former capacity it heard suits relating to the royal revenue, and in its latter it collected the revenue. Down to 1875, it will be remembered, the Chancellor of the Exchequer was entitled to sit as a Judge along with the Barons, and for the sake of formality a newly appointed Chancellor of the Exchequer used to sit as a Judge and hear a case or two.

In 1834 an Act was passed abolishing the old office of the Exchequer, and the elaborate ritual of triple-locked chests and of wooden tallies was done away with and the highly fee-paid sinecures, the Auditor of the Receipt, the Tellers and the Clerk of the Pells,² were abolished, and in their place a department under a amount actually paid), in the entry of the pell or receipt. Tallies of Pro, from the word *pro*, for the benefit of, the person named, were instruments of payment and were like a modern cheque on a banker. It was given by the Exchequer as a charge upon some public accountant, who paid the sum thereon out of the revenues in his hands. The Pro tally was a voucher or cheque and was the same as if money had been actually paid into the Exchequer of Receipt. The Tallies of Pro are sometimes called the Tallies of Assignment, or of Anticipation. The tally was a willow stick about one inch in depth and thickness and not exceeding five feet in length. The stick was split in half lengthways through the notches, one-half constituting the tally, the counter tally or the counterfoil being kept at the Exchequer as a check. The transaction was written in duplicate on each side, and both parts could easily be fitted together if the payment was disputed.

¹ Hall, *The Antiquities and Curiosities of the Exchequer*, 1891, p. 131. Cf. *History and Antiquities of the Exchequer from 1066 to Edward II.*, with a Copy of the Ancient Dialogue by Gervasius Tilburiensis and the Roll of Quinto Regis Stephanii (Thomas Madox, 2 vols., 2nd edition, 1769).

² Pell is a skin or roll of parchment kept at the Exchequer from early times. There were two pells, the pell of receipt (*pellis receptorum*) and the pell of dis-

single Comptroller, whose independence was guaranteed by his salary being charged like those of the Judges on the Consolidated Fund and not subject to annual vote, took charge of the newly organised department. The detailed business of making payments was transferred to the Paymaster-General, whose office was further enlarged in 1836 and 1848. In 1866 the Exchequer was abolished altogether as a distinct department of State, and a new department, the department of the Exchequer and Audit, was established in its place. The ancient term Exchequer now survives only in the name of the Chancellor of the Exchequer and in the title of the national banking account of the United Kingdom, the central account of which is called "His Majesty's Exchequer" or "The Account of the Consolidated Fund of Great Britain and Ireland" (formerly at the head office in Dublin, now at the Belfast branch only). The banking account solved the problem of the custody of the public money.

The Exchequer was in the palace of Westminster. It must be admitted that the system of control and check worked on the whole well, because there are only two robberies mentioned from the Norman Conquest down to 1834. The first was in 1303 in the thirty-first year of Edward I.'s reign, when the King was absent from Westminster, being then in Scotland. The wall of the Chamber was broken through and much treasure, gold, silver, and jewellery, stolen. The whole loss was equivalent to nearly £2 millions at the present time. According to Palgrave's *Kalendars of the Exchequer*, this was perhaps the earliest record of a formal criminal proceeding by the Crown. Eleven monks were the principal criminals, and at their instigation John the mason, assisted by Adam the carpenter, broke through the wall of the Treasury. It was found that the robbery was actually effected by Richard de Pudlicote, that William the porter at the King's palace was an accomplice, and that Geryn le Lyndraper received some of the plunder and hid it in his house and garden and afterwards removed it to a hedge in St. Pancras Fields, from where it was recovered. Nineteen other persons were found guilty of being accessories to the robbery, which took four months to carry out. Eleven monks of the Abbey of Westminster bursement (*pellis exitum*). In the plural it meant the Office of the Exchequer in which these were kept, and the Clerk of the Pells therefore was an officer responsible for the receipts and disbursements on the parchment rolls in the Exchequer.

together with fifteen other persons were committed to the Tower, and eight other persons were sent to Newgate, including Joanna, daughter of Richard le Tailleur, concubine of Richard de Pudlicote, the monk who subsequently confessed the whole matter. Much of the plunder had been concealed in the enclosure within the cloisters used as a cemetery, which had been purposely sown with hemp in the spring, the persons having charge of the enclosure being parties to the robbery. The thieves were embarrassed by the amount of gold, silver, and jewels, and they left behind considerable amount of treasure, including the King's great crown and three other crowns, and also a great quantity of jewels and plate. The robbery took place in the Pyx Chamber in which was also kept the Pyx chest.¹ The door was lined inside and outside with human skins and driven full of nails. Scott in his *Gleanings from Westminster Abbey* states that he recently found a piece of what seemed to be white leather remaining on the door, which was proved to be human skin, and he refers to an old tradition that they were skins of Danes, tanned and fixed there as a memorial of deliverance from them. He was, however, of opinion that they were not the skins of Danes but of persons executed for sacrilege, and that the custom of lining the doors with these human skins was intended to terrify other depredators. The second robbery was in 1729, when the office of one of the Tellers of Exchequer at Westminster was broken into and over £4191 stolen. The tradition in the Exchequer was that the entrance into the Teller's office was obtained from a lower room by breaking through the floor; but no trace of the thieves was ever found. The money was replaced out of the sinking fund under a Parliamentary vote.

The Exchequer to-day is a department which authorises payments by Government departments after an examination has been made that there is Parliamentary authority. The Exchequer, too, examines the accounts in order to see that all expenditures have been in accordance with Parliamentary authority. The Comptroller and Auditor-General is, therefore, the watch-dog of Parliament. The Treasury, on the other hand, is the administrative department of Government responsible for the Budget and the management of the national revenue, although

¹ Cf. the Pipe Roll of 11 Henry II. (1165). The Assayers of the Pyx appear in 1281.

the actual collection of revenue is made through the Commissioners of Inland Revenue and the Commissioners of Customs and Excise—two departments which are distinct from the Treasury but closely connected with and subordinate to it. Revenue which is actually earned is collected by the departments concerned, such as the Post Office. The Treasury supervises all other departments and stands among the departments of State pre-eminently apart. It would not be wrong to say that it is the fountainhead of the whole administration of the country financial or otherwise. It is concerned with the management of other departments in regard to salaries, wages, accommodation, etc. It performs the day-to-day work which is concerned with supply (or public expenditure) and is responsible for finance which is related to the receiving of loans, currency, banking, and the like. It is the central agency of the Government continuously supervising the details of the work of other administrative departments, so that money is not wasted and financial sacrifice is standardised among the departments. It exercises a direct control by the mere fact that the House of Commons grants the credit to the Crown and not to Ministers. The Crown must state how a credit is to be used, and it is the Treasury through which the Crown makes its will known. Therefore a Minister must obtain Treasury authorisation before making any expenditure. When Parliament has granted supply to the King, no money can come out of the Exchequer except in obedience to a warrant under the royal sign-manual countersigned by two Lords of the Treasury. Generally speaking, nothing can be done in any way involving expenditure of public money, not even in regard to the Army, Navy, and Air Force, without the consent of the Treasury. It may contract short-term loans, ways and means advances from the Bank of England, or raise Treasury bills through the agency of the Bank. It issues in the form of Treasury Minutes, based on the Committee on Public Accounts of the House of Commons, instructions regarding public expenditure and accounts.¹ It corresponds to the Ministry of Finance in most European countries, although it enjoys a status to which many of these look with envy. The confusion which sometimes exists between the functions of the two departments, the Exchequer and the Treasury, arises from

¹ Vide *The Epitome of the Reports from the Committees on Public Accounts 1857 to 1910, and of the Treasury Minutes thereon.*

the fact that the Finance Minister, *i.e.* the *de facto* head of the Treasury, is called, for historical reasons, the Chancellor of the Exchequer, although he has little or nothing to do with the Exchequer except in regard to (1) the appointment of the Comptroller and Auditor-General, and (2) the Treasury's statutory relations with the Exchequer department. He has indeed no statutory power over the Exchequer apart from his position as second Commissioner of the Treasury. He with the Permanent Secretary (who is also Head of H.M. Civil Service¹) and a permanent staff is responsible for the daily work of the Treasury. The Chancellor of the Exchequer is not only in control of expenditure but also of revenue. He is therefore in a position to impose an effective restraint upon the demands of his colleagues. It is sometimes argued that he should not be in charge of both revenue and of expenditure at the same time. But if he is to keep the reservoir full of water he must also be in a position to regulate its outflow.² By virtue of his office, he is also Master of the Mint; Senior Commissioner for the reduction of the National Debt; a Trustee of the British Museum; an Ecclesiastical Commissioner; a Member of the Board of Trade; a Member of the Board of Agriculture; a Commissioner of Public Works and Buildings, Local Government, and Education; and a Commissioner for regulating the office of the House of Commons.

During the eighteenth century the Lords of the Treasury used to meet at a Board and transact business. The practice of holding such formal meetings was maintained until 1856, since when these meetings have been discontinued. Gradually the legal and administrative functions were separated, and the fiscal work was placed under the control of the Lord Treasurer assisted by the Chancellor of the Exchequer, while a Chief Baron and three or four other Barons did the judicial work. The earliest record of the appointment of a Chancellor of the Exchequer is the 18 Henry III. (1234). The author of the *Dialogue on the Exchequer*

¹ The papers regarding the decision to give the Permanent Secretary of the Treasury the designation also of Head of H.M. Civil Service have been lost, as the Prime Minister informed the House of Commons. In some quarters this designation has given rise to criticism. But it is an undoubtedly fact.

² The tendency to make the Treasury a spending department by placing the Chancellor of the Exchequer in charge of Bills such as Old-Age Pensions, Unemployment Insurance, or Public Assistance during their passage through the House or in charge of these after they have been passed into law, is to weaken financial control.

tells us that he was bound equally with the Treasurer to see to the correctness of the Great Roll. If the Treasurer was in error he was "to rebuke him with modesty and to suggest what ought to be done". If the Treasurer persevered, the matter was to be argued before the Barons, and left to their decision. The Chancellor of the Exchequer had to take charge of the King's Seal (*cancellarium*) which was in the Treasury as well as to keep a check upon the Treasurer.

The present functions of the Chancellor of the Exchequer with regard to revenue matters may be traced as far back as the time of Henry VII. Under Henry VIII. the office of the Chancellor of the Exchequer was combined with that of the Lord Treasurer in the person of Thomas Cromwell. From 1612 the office of the Lord High Treasurer of England was placed in commission except for certain intervals, and the Treasury, which originated between the eleventh and fourteenth centuries as a branch of the Exchequer,¹ was placed under Lords Commissioners of the Treasury. With the disappearance of the Lord High Treasurer the Chancellor of the Exchequer is one of the most important appointments under the Crown, though in the official hierarchy he is placed inferior to some of his Cabinet colleagues. Acts of Parliament frequently state that this or that matter shall or may be done by the Treasury. The Act of 1859 declares this to mean that the requisite document shall be signed by two of the Commissioners.

THE FINANCE MINISTER AND THE BUDGET

3. One of the many lessons of the Great War is that there can scarcely be a more patriotic or more far-reaching service to the State than that of presenting a balanced Budget. This necessitates unusual qualities on the part of a Finance Minister. He has to bring to the task of public finance a mind keen and alert, an intelligence trained in the best of schools, a natural capacity for business, a genuine and practical sympathy with various communities, especially the mercantile community, and a keen

¹ Cf. Madox, *History of the Exchequer*: "The Exchequer was at first a general name, signifying as well the place where the King's revenue was supervised and managed, as that where it was wont to be paid in. In the early time that part of the Exchequer where the King's treasure was told, reposed, or issued, was usually called Thesaurus. In process of time, the receipt of Exchequer was usually called Inferius Scaccarium, Scaccarium de Recepta, and Recepta Scaccarii" (p. 179).

desire to be up and doing. He must be, as Lord Morley would have said, a paragon. A Finance Minister is not merely a veritable lion of the Treasury, but also a vigilant guardian of the public purse, who upholds the arms of the Government in its annual struggle with the Amalekites in Budget debates. He is something more than a framer of taxes and a manipulator of Budgets. He must never resist the dictates of common sense, and must show a readiness to meet criticism and an anxiety to win his point by carrying conviction that is not always found behind an official waistcoat. His mind, in Emerson's phrase, must be "locked and bolted to results". Wellesley, a former Governor-General of India, once said that the secretaries of the Government of India combined the industry of clerks with the talents of statesmen. The financier must exalt the statesman and eliminate the clerk. He ought not to be selected for political prowess or, worst of all, for mere seniority in a country's service. He would then be no better than a financial mandarin of the Celestial Kingdom, clad in yellow jacket, a peacock feather, and a red button, possessing little or no knowledge of *la haute finance*.

Owing to the advance in statistics in the last few decades, greater accuracy in the Budget is now possible. There is at hand a greater mass of information regarding the commercial, industrial, and agricultural life of a country than at any moment hitherto. One can hardly believe that in Great Britain until 1802 no regular statement of the finances of the country was published, and until 1822 no balanced annual account of the public income and expenditure was regularly presented to Parliament.¹ In some countries a Finance Minister's duties have been combined with those of other administrative functions, often, if not always, to the country's financial detriment, as he cannot then possess the severe detachment and independence so necessary for the proper discharge of his duties. There was, for example, no Finance Member of Council in the Government of India until 1859, when Wilson's capable hands took the financial tiller. Similarly, Alexander Hamilton's brilliant work in a short life—he was killed in a duel at the age of forty-seven near Weehawken, opposite New York—is a great example of the value of specialisation and independence in this sphere.

¹ Anson, *Law and Custom of the Constitution*, part ii p. 318 (Clarendon Press, 1892).

THE PREPARATION OF THE BUDGET

4. The executive or the administration prepare the Budget for the legislature. It is of importance to study the financial systems in this regard in the case of Great Britain, France, Germany, the United States, and India, and to show from a study of these the main principles underlying the preparation of the Budget.

The preparation of the British Budget is a lengthy process. It has already been shown that no proposal involving expenditure can be effected without Treasury sanction. During the financial year, therefore, departments approach the Treasury with requests to sanction additional expenditure, either recurring or non-recurring, or forthwith or from some future date. The Treasury requires a statement with full explanations and then decides whether to accept or to refuse the proposals in whole or in part. If the proposals are accepted, the decision is referred to the Treasury estimate clerks, who note it for the preparation of the next Budget. On 1st October the Treasury sends a circular to the various departments requesting them to prepare their budgets for the next financial year. These estimates are subject to a careful check in the accounts department of each office, and again in the Treasury, where each item is examined and Treasury authority for it checked. The reasons of any increase, temporary or otherwise, are examined and the possibility, as in stores, for lower estimates when there is a fall of prices and similar intelligent scrutiny are brought to bear on these estimates. When approved or modified by the Treasury these are published in separate volumes classified in detail according to services, and presented to Parliament. Expenditure connected with the fighting services must also be approved by the Treasury, especially in regard to the pay of the civilian staff. But the strength of the forces is a matter of high policy which is settled in the Cabinet and technical requirements are not susceptible to minute Treasury examination. Each of the fighting services, however, has a high financial officer whose duty it is to watch over the financial interests within his department. The estimate of the Consolidated Fund charges, which are not voted annually by the House of Commons, is next prepared. This includes charges resting upon statutory foundation such as the National Debt payments, payments to local authorities, the Civil List, salaries and pensions of Judges, the

Speaker of the House of Commons, the Comptroller and Auditor-General, and others whose independence is maintained by depriving the House of Commons of an opportunity for criticism which would be afforded if the salaries were voted annually. These charges and the supply charges are added together and give the total expenditure which the revenue has to meet. The revenue estimates are prepared in the light of many factors such as the state of trade, the growth of population, and similar factors. The revenue departments—the Inland Revenue, Customs and Excise, and the Post Office—make detailed estimates of receipts based on the existing basis and on the basis of any changes which are to be introduced in the Budget. The Treasury then allows for capital transactions and miscellaneous revenue and strikes the balance of the estimated surplus or deficit. The final result usually shows a surplus after taking into consideration various contingencies. The Chancellor of the Exchequer lays before the Cabinet his draft Budget and the measures by which he proposes to meet the financial needs of the nation in the coming year. After approval or criticism by the Cabinet, the Budget is prepared in its final form and presented to the House of Commons, when the Chancellor of the Exchequer makes his annual Budget speech.

In France the budgetary system dates back to the Law of 25th March 1817.¹ The financial administration is under the Ministry of Finance. Since 1925, however, a Ministry of the Budget exists side by side with the Ministry of Finance, and this dual administration has not been beneficial. The French Budget, in contrast to the German Budget, is weak in regard to the power of the executive although strong in regard to the legislature. The Ministry of Finance does not exercise any effective control over the financial activities of the other ministerial departments. The preparation of the Budget begins as early as eighteen months prior to the period to which it refers, and much happens in so long a period to vitiate the accuracy of the estimates. The Minister of the Budget is inferior to the Minister of Finance and is not superior to the other Ministers. The latter submit to the Minister of the Budget their proposed expenditures, but he has no power

¹ Article 151. Modifications to be found in the Laws of 14th September 1822; 1st September 1827; 15th May 1850, Article 9; 30th April 1921, Article 43 and subsequently.

to control them. After a series of inter-ministerial negotiations during which the Council of Ministers may be called upon to settle disputes, the Budget is completed and submitted to the Chamber usually five months before the opening period of the Budget. The powers of both the Minister of Finance and the Minister of the Budget are much impaired by the "Commission des Finances" of the Chamber of Deputies and that of the Senate, and by the Deputies and Senators themselves. Because of the weakness of control and responsibility for the Budget, supplementary estimates are of much importance. In these circumstances, as Gaston Jèze has well said, "the authority of the Minister of Finance and the Minister of the Budget depends entirely upon their personalities. The French Budget has no responsible author; it is the offspring of an unknown father." The Ministry of Finance has an official, the Contrôleur des dépenses engagées, in each ministry who supervises expenditures. It is true that all proposals involving expenditure must be submitted to him for countersignature, but in practice this power is considerably reduced. If he refuses countersignature, an appeal is made to the Minister of Finance, who gives the final decision. The Minister of Finance, it may be noted, has the power to incur public expenditures regardless of their legality. His orders must be obeyed by the Contrôleurs and the Accountants, even if contrary to law. In practice the Contrôleur is not allowed to deal with the expediency of expenditure, although he has the right to comment on the efficiency of the methods employed. His duty is to see whether the expenditure is in conformity with the credits voted by Parliament¹ and generally in accordance with the law. By the Law of 10th August 1922 a Minister who incurs expenditure without the endorsement of a Contrôleur is held civilly and criminally responsible, but the Law has never been enforced. This Law, it is interesting to note, authorises the Government to open credits by a decree of the Council of Ministers for expenditures necessary in the interest of security, provided that these credits are subsequently ratified by Parliament. The Government makes frequent use of this power, which tends to decrease Parliamentary control. Another feature of the French Budget is that all fiscal items are not included, and thus Budget unity is

¹ The word *Parlement* is used to describe the legislature—the Chambre des Députés and the Sénat.

not, as in Great Britain, adequately preserved. The Minister of Finance is responsible for the collection and the distribution of the public revenues, for the national debt, and the auditing of the public accounts. There is no office comparable to the office of Comptroller and Auditor-General in England, which sees that the Minister of Finance carries out the will of Parliament. The Minister of Finance himself is the only authority charged with this. The executive in France has a less share in the preparation of the Budget than in Germany, and much less than in the case of the United Kingdom.

The budgetary procedure in Germany is outlined in the Budget Act, "Reichshaushalts-ordnungsgesetz", of December 1922.¹ The Constitution itself contains several specific provisions regarding budgetary procedure. The Budget is a unified single budgetary system with twenty subdivisions. It is called the *Gesamtplan*, classified according to ministries, other governmental bodies, and in several instances by functions which are not carried out by the ministries. Expenditure is classified into ordinary and extraordinary categories, but there are no annexes or extraordinary budgets as in France. The receipts from, and advances to, the *Länder* are included in the Reich Budget, and this enables the Reich to have general control over local finances. The preparation of the Budget is undertaken by the Ministry of Finance. The Finance Minister has much larger powers than in France and he possesses the right to criticise the proposed expenditures of other Ministers, and when necessary the matter goes before the Cabinet. The Minister of Finance can insist that the Council take a fresh vote at the meeting at which all Ministers are required to be present, and the credit is granted only if the majority of the Ministers are in favour of it and if the Chancellor of the Reich votes with the majority. Each ministry or authority or individual authority submits its plan before 15th August in each year to the Minister of Finance, who reviews the estimates and holds conferences with various Ministers. The Budget approved by the Council of Ministers is submitted to the Reichsrat, a body composed of delegates from the states, where it is examined by a Commission of which the chairman is the Minister of Finance. The Minister may ask that the modifications proposed by the Reichsrat be submitted to the Council of Ministers.

¹ Amendments to the Act are found in the Laws of 14th April 1930 and 13th December 1933.

The Ministers may approve or reject these. If the Budget is approved it is next submitted to the Reichstag, which, however, on 23rd March 1933 virtually gave absolute power to the Chancellor and his Cabinet. The Enabling Act passed on the following day permitted the Cabinet to make laws by ordinances, even including such laws as are not in accordance with the Weimar Constitution. By the Law of 1st February 1934 the sovereign rights formerly possessed by the Federal states passed into the hands of the Reich Cabinet. The Reichstag's powers are under the Hitler régime merely advisory. In the German financial system the Minister of Finance cannot control his colleagues' expenditure to the same extent as in the English system. He is not even authorised to have controllers of expenditure of his own in each ministry. The Ministers have their own special officials who look after the expenditure. The system of monthly distribution of funds is modelled on the French system, the Minister of Finance determining the amount to be passed for payment. The Minister of Finance is in charge of the collection and preservation of revenues and also of the issue of public loans. The actual administration of the national debt is reserved to an independent organ, the Reichsschuldenverwaltung. The Reichsbank works in close co-operation with the Ministry of Finance and discounts its short-term certificates. There is no office to ensure compliance with the Budget law as passed by the Reichstag, although there are special Budget officers in each ministry looking to this work. It may be said without fear of contradiction that on the whole the Minister of Finance has less power in financial administration than has the Chancellor of the Exchequer, but greater power than his colleague in the French system. The part played by the Reichsbank in financial administration is also inferior to that of the Bank of England or the Bank of France.

The most remarkable feature in financial administration in the United States in the present century was the adoption of the executive Budget first by a large number of cities and local authorities and by all the states, and in 1921 by the Federal Government itself. In order to improve municipal administration special attention was given to the administration of finance upon a budgetary basis as far back as 1899, when the National Municipal League drafted a Municipal Corporation Act in which the presentation of a Budget by the head of the executive was proposed

and no council was to increase any item in the total of the Budget. A number of states imposed a budget and an accounting system upon their counties and other local governments. The framing of budgets by a board consisting of members who are administrative heads of State departments and are in some cases members who have no administrative duties, is disappearing. The legislative budget, however, in contrast to the executive Budget, is still common among counties and other local governmental authorities. The movement in favour of the executive Budget spread from municipalities to the states beginning with California, Wisconsin, and Massachusetts in 1912. By 1916 all but two states of the Union had passed budgetary legislation of some sort. Seven states have written budgetary provisions into their Constitution. In one or two states only is the preparation of the budget still of an unsatisfactory character. In Maryland, one of the states to provide for a budget in its Constitution, the Governor is required to obtain estimates from the various divisions of the Government which he may revise except those relating to the legislature, judiciary, and school system. He submits his estimates in the form of two budgets and two bills for one year each, since the legislature meets only once in two years. The legislature may not increase those relating to the branches of Government other than the legislature and judiciary, but may reduce other heads with certain exceptions such as salaries for officers during the term for which they have been appointed. The Massachusetts budget plan is similar to the Maryland budget, except that the legislature may make increases subject to the authority of the Governor to veto individual items in appropriation bills. In California no appropriation bill, unless for legislative expenses, may be passed without the approval of the Governor. The Governor may reduce or eliminate items, but the legislature by a two-thirds vote may override his decision. In Pennsylvania the Secretary of State appointed by the Governor is the budget officer. The legislature is not limited in its action on the budget, but the Governor may veto particular items of appropriation bills. In Wisconsin a board of affairs is in charge of the preparation of the budget and consists of the Governor as chairman, three of his appointees, the Secretary of State, the President of the Senate, the Speaker of the House of Representatives, and the chairmen of the two legislative finance committees. In Vermont, Tennessee,

see, New Mexico, Utah, Illinois, and Nebraska an executive budget is prepared, but in other states budgets are largely the result of legislative rather than of executive action. The Institute of Government Research in 1916 prepared and secured the adoption by Congress on 10th June 1921 of a Bill providing for a budgetary system which was passed into law as "The American Budget and Accounting Act, 1921". Previous to this there was no executive Budget in the Federal Government. As late as 1917 there were twenty-nine separate Committees of Congress, fourteen in the House of Representatives and fifteen in the Senate, which prepared Bills requiring expenditure of public moneys. Ten of the House Committees and eight of the Senate Committees reported appropriation measures, but other Committees had charge of matters which required appropriations to be prepared by some one of these appropriation Committees. The Committees were entirely independent of the executive, and indeed were independent of the Committees in charge of revenue. There was, in short, no complete financial plan. No request for funds by administrative officers may now be made except through the Budget unless Congress specially requests it. The Budget is prepared by the Bureau of the Budget, which is housed in the Treasury, at the head of which is the Director of the Budget, who is responsible to the President of the United States. The preliminary estimates are prepared by the Budget Bureau along lines approved by the President for his fiscal programme. The President is no longer merely *de jure* head of the administration, but is now *de facto* as well. The Act has changed also his relations with the various administrative departments and with Congress. Expenditures may be decreased or deleted by the Administration unless these involve failure to carry out the enacted activities. Under emergency legislation during the Trade Depression of 1931 to 1935, wide discretionary powers regarding changes in expenditure and appropriations were vested with the Director of the Budget. The preparation of the Budget requires about six months and the President submits it usually to the Congress shortly after the opening session in January. The revenue estimates are prepared under the joint supervision of the Budget Bureau and the Treasury. The Secretary of the Treasury, however, cannot be compared in Budget matters with the Chancellor of the Exchequer because of the pre-eminence of the President.

and the Bureau of the Budget. The important position of the President and the Director of the Bureau is well seen from the Act itself. Section 201 of the Act prescribes that "the President of the United States shall transmit to Congress on the first day of each regular session, the Budget, which shall set forth in summary and detail :

"(a) Estimates of the expenditures and appropriations necessary in his judgment for the support of the Government for the ensuing fiscal year ; except that the estimates for such year for the Legislative Branch of the Government and the Supreme Court of the United States shall be transmitted to the President on or before October 15th of each year, and shall be included by him in the Budget without revision ;

"(b) His estimates of the receipts of the Government during the ensuing fiscal year, under (1) laws existing at the time the Budget is transmitted, and also (2) under the revenue proposals, if any, contained in the Budget ;

"(c) The expenditures and receipts of the Government during the last completed fiscal year ;

"(d) Estimates of the expenditures and receipts of the Government during the fiscal year in progress ;

"(e) The amount of annual, permanent, or other appropriations, including balances of appropriations for prior fiscal years, available for expenditure during the fiscal year in progress, as on November 1 of such year ;

"(f) Balanced statements of (1) the condition of the Treasury at the end of the last completed fiscal year, (2) the estimated condition of the Treasury at the end of the fiscal year in progress, and (3) the estimated condition of the Treasury at the end of the ensuing fiscal year if the financial proposals contained in the Budget are adopted ;

"(g) All essential facts regarding the bonded and other indebtedness of the Government ; and

"(h) Such other financial statements and data as in his opinion are necessary or desirable in order to make known in all practicable detail the financial condition of the Government." ¹

¹ Act, June 10, 1921, C. 18, § 201, 42 Stat. 20. Barnes Federal Code, 1923, cumulative Supplement (Indianapolis, The Bobbs-Merrill Company). Barnes Federal Code, 1919, contains information up to December 1918 : the 1923 Supplement refers to the years 1919-1922.

It is also prescribed in Section 202 of this Act that :

“ (a) If the estimated receipts for the ensuing fiscal year contained in the Budget, on the basis of laws existing at the time the Budget is transmitted, plus the estimated amounts in the Treasury at the close of the fiscal year in progress, available for expenditure in the ensuing fiscal year, are less than the estimated expenditures for the ensuing fiscal year contained in the Budget, the President in the Budget shall make the recommendations to Congress for new taxes, loans, or other appropriate action to meet the estimated deficiency.

“ (b) If the aggregate of such estimated receipts and such estimated amounts in the Treasury is greater than such estimated expenditures for the ensuing fiscal year, he shall make such recommendations as in his opinion the public interests require.”

And also in Section 203 in regard to supplemental grants or deficiency estimates that :

“ (a) The President from time to time may transmit to Congress supplemental or deficiency estimates for such appropriations or expenditures as in his judgment (1) are necessary on account of laws enacted after the transmission of the Budget, or (2) are otherwise in the public interest. He shall accompany such estimates with a statement of the reasons therefor, including the reasons for their omission from the Budget.

“ (b) Whenever such supplemental or deficiency estimates reach an aggregate which, if they had been contained in the Budget, would have required the President to make a recommendation under subdivision (a) of Section 202, he shall thereupon make such recommendation.”

The Bureau has the authority “ to assemble, correlate, revise, reduce or increase the estimates of the several departments and establishments ” (section 207). The head of each department appoints a Budget officer who prepares the estimates of appropriations (section 214), and these officials are liaison officers between the departments and the Bureau, the Bureau dealing directly with them in the routine work of the Budget. They supply estimates to the Bureau in prescribed forms (section 216). The Bureau of the Budget may also be directed by the President to inspect departments and establishments in order to determine what changes should be made in the interest of economy and efficiency in “ (1) the existing organisation of activities, and

methods of business of such departments or establishments ; (2) the appropriations therefor ; (3) the assignment of particular activities to particular services ; or (4) the regrouping of services " (section 209). The Bureau of the Budget may obtain under presidential regulations any information which it requires, and officials of the Budget Bureau have access to the records of any department which they wish to inspect (section 213).

There are six steps in the preparation of the American Federal Budget which are : (1) the President's financial policy ; (2) the preliminary estimates ; (3) the final estimates ; (4) the hearings before the Board of Estimates of the Bureau ; (5) the estimates returned to departments for revision ; and (6) the preparation of the Budget document itself. The Budget document is a volume of 1500 pages published by the Bureau of the Budget and is very comprehensive.

The contrast before and after 1921 is startling. Before that year the problem of financial administration as a whole in the United States left much to be desired. The Secretary of the Treasury was merely a compiling officer who is to submit estimates to Congress. He had power to modify the proposals transmitted to him by the heads of the various departments. The President had no department at his disposal through which he could effectively exercise his authority. In Congress itself there was division of responsibilities owing to the many Committees. Since 1921, however, the President is charged with the preparation of the Budget estimates on specific lines, and he is assisted in his task by the Bureau of the Budget with a Director responsible to the President only. No department now may submit to Congress direct an estimate for appropriations. Congress itself has done away with the numerous Committees, and has one strong Committee on appropriations in the House of Representatives and one Committee on appropriations in the Senate. The result has been a considerable saving in expenditure and a very great improvement in financial administration which has not only affected the Federal Government but has spread to states and local authorities.

The Budget in India is presented to the legislature usually four weeks before the close of the financial year, which ends on the 31st of March, so that the whole of the discussion may be completed before the year begins. Various heads of departments prepare their estimates, and in some cases these are taken in hand

as early as August of the year previous, *i.e.* six or seven months before the end of the financial year. The returns filled in by administrative officers are in three parts: (*a*) the revenue and standing charges of a more or less permanent nature, which, though they may vary from year to year, are not dependent on the head of the department. These charges are, for example, the salaries of the permanent establishment and ordinary contingent expenditure; (*b*) charges which are fluctuating from year to year, but are not new objects of expenditure. Ordinarily, stores required by the department are of this nature; and (*c*) new items of expenditure. The estimates give the actual expenditure of the previous year, the sanctioned expenditure for the current year, and the probable expenditure for the coming year. Explanations are given of increases or decreases, and these are compared with the current year. One of the rules followed in the preparation of these estimates in this country is not to include in the estimates any new charge unless sanctioned by competent authority. The heads of offices submit their estimates to the administrative departments of Government at headquarters, which in turn scrutinise the estimates. Part I. of the returns, (*a*) above, is mainly scrutinised by the Administrative Department and the Accountant-General. The second part, (*b*) above, is reviewed by the Finance Department and the Accountant-General, the Accountant-General accepting the orders of the Finance Department as final in this respect. The third part of the return is that which receives the most careful scrutiny. The head of the office has to obtain the administrative approval of the department before the expenditure can be placed in the Budget. The Finance Department also scrutinises carefully these new items. The administrative departments then forward to the Finance Department memoranda explaining the necessity for each new item of expenditure, in order that these explanations may be placed first before the Finance Committee of the legislature, and then before the legislature itself in a statement of new items showing (1) the cost of the new items and the head by which it should be borne in the Budget; (2) whether the cost is recurring or non-recurring; and (3) any explanatory memorandum showing the reasons for this new expenditure. The Accountant-General includes in the preliminary Budget forecast submitted to Government in December these approved items.

The Accountant-General prepares two editions of the Budget : (1) on the basis of the actual eight-monthly figures, and (2) on the basis of the nine-monthly figures. The duty of consolidating the estimates devolves on him for the provinces, the Finance Department deciding which figures shall be taken as final. The second edition of the Budget is prepared by about the second week of February, and important changes based on ten months' actuals are incorporated in the Budget. With the completion of this the preparation of the Budget is ended, and it is ready for presentation to the legislature. Eight months after the beginning of the financial year, usually in November, four sets of figures are available for Budget purposes : (1) the accounts or final figures of the previous year; (2) the Budget estimates of the current year; (3) revised estimates for the current year ; and (4) the Budget estimates for the following year.

The Government of India Budget, as distinct from the provincial budgets, includes, in addition to the expenditure of civil departments, the expenditure of non-civil departments, such as military finance, posts and telegraphs. It includes also expenditure incurred by the India Office, except that portion which is a part of the British Budget, and also of the office of the High Commissioner for India in London, whose estimates are forwarded to the Government of India for inclusion in their Budget. The railway budget is now separate from the main Budget, the net contribution to the latter by railways alone being shown. The narrower the time between the preparation of the Budget and the period to which the Budget refers, the closer will be the accuracy of the forecast. In India, however, the Budget is prepared before the monsoon falls, and there is therefore considerable uncertainty in the finality of the figures. There is usually a very detailed statement, called "the Budget estimates ", which gives in detail the expenditure for each office in the administration. In Great Britain such a statement is called the "civil estimates ". They are part of the Budget, and are to the legislature of much importance.

The financial procedure in India in regard to the Budget, in so far as the executive is concerned, is of considerable interest to the student of public finance. It is based on the principle which is now recognised as the foundation of any sound system of Budget procedure, that no proposal for the imposition of taxation or for

the appropriation of public revenues should be made to the legislature except by the executive. In this respect Budget procedure is similar to that of Great Britain. In some respects, however, there are differences. There is no annual Appropriation Act in India. The proposals for the appropriation of revenues submitted by the Government require only a vote of the legislature in the form of demands for grants, and a resolution of the legislature approving a demand is sufficient legal warrant for the appropriation. The Budget or annual financial statement provided for in the Government of India Act of 1935 distinguishes expenditure on revenue account from other expenditure, and sums required to meet expenditure are divided into three categories : (1) those which are open to discussion but are not to be submitted to the vote of the legislature ; (2) those which will be submitted to the vote of the legislature ; and (3) proposals, if any, which the head of the executive (*i.e.* the Governor-General in the case of the Federation and the Governor in the provinces) may regard as necessary for the fulfilment of any of his special responsibilities. In the first category are included (1) debt charges ; (2) the salary and allowances of the head of the executive, including personal or secretarial staff, salaries of Ministers, Judges, and the salaries and pensions payable to certain members of the Civil Service, and certain other sums such as provident and family pension funds ; and (3) in the case of the Federal Government, expenditure for the purpose of the discharge by the Governor-General of his functions with reference to defence, ecclesiastical affairs, and to external affairs. Most of the heads of expenditure of the first category are identical with, or analogous to, payments which would in the United Kingdom be described as Consolidated Fund charges and as such would not be voted annually by Parliament. There are two principal exceptions to this principle, viz. the salaries of Ministers and the salaries and pensions payable to certain members of the Civil Services or to their dependants. The convention in Great Britain whereby a motion for a nominal reduction in the salary of a Minister has become a useful method of criticising a department or ventilating a grievance, has not established itself in India, and experience has shown that the legislatures have misused their powers in such a way as to deprive Ministers of their whole salaries and to prevent a ministry from functioning at all. The safeguarding of the Civil Services under

responsible government has also been necessary. All other estimates of expenditure embodied in the Budget are subject to the vote of the legislature, except where in regard to any demand which is necessary for the fulfilment of the special responsibilities of the head of the executive. Most of the heads of expenditure not subject to vote would not even in the United Kingdom be subject to an annual vote in Parliament, and the inclusion of those which do not fall within that category is justified as a matter of reasonable precaution in order that responsible government itself, as the Joint Parliamentary Committee has pointed out, may be a reality in the future.

In the Federal legislature the Governor-General must lay the Budget before both Chambers, and the Governor in the case of provinces before the Chamber or Chambers. The Budget in all cases must show (1) the sums required to meet expenditure upon the revenues of the Federation in the case of the Federal Government, and in the case of the provinces expenditure charged upon the revenues of the provinces, and (2) sums required to meet other expenditure proposed to be made from the revenues of the Federation or of the provinces, as the case may be. Expenditure on revenue account has to be distinguished from capital expenditure. Sums, if any, to be included solely because the Governor-General or the Governor has directed their inclusion as being necessary for the discharge of his special responsibilities, must also be submitted in the form of demands for grants to the Assembly and thereafter to the Council of State. Supplementary statements of expenditure may be submitted to the legislature by the executive during the financial year when required and classified, as in the main Budget, in regard to sanction by votes. A similar procedure is followed in the case of legislatures in the provinces.

THE FISCAL YEAR

5. In the preparation of the Budget there are one or two matters of importance which require further examination. In the first place there is the question as to the period to which the data should refer. Should it be a twelve-month, and should it be the calendar year? In several states of the Union the budgetary period is biennial and in Alabama it is quadrennial. Before the War, in some German states biennial budgets were in vogue,

and in one state at least—Hesse—a triennial budget was presented. In Prussia expenditure on the Army was for seven years at a time. The objection to a period longer than a year is a real one. It removes popular control over the executive and conceals important variations. A period shorter than a year ignores accidental changes and upsets administrative departments. For this reason supplementary budgets should be avoided, although, as we shall see, not necessarily supplemental grants or, in American phraseology, “deficiency bills”.

The date of commencement of the fiscal year varies from country to country. In England from 1508 to 1799 the year ended at Michaelmas (10th October); from 1800 to 1832 the year ended on 5th January; from 1833 to 1854 it ended on 5th January, 31st March, and 5th April. The reform of adopting a financial year ending on one date, 31st March, was carried out for the first time in the year ending 31st March 1855. In India the present financial year, following that of England, was introduced with effect from 1866.¹ The financial year ending 31st March is used not only in Great Britain and India, but also in Canada, New Zealand, the Union of South Africa, Japan, Siam, Germany, Bulgaria, Denmark, Greece, Poland, and Rumania. The financial year ending 30th June is followed in the United States, Australia, Italy, Hungary, Norway, Sweden, Mexico, Newfoundland, and China. The change from the calendar year took place in the United States from 1844. The financial year coincides with the calendar year in France, Belgium, the Netherlands, Spain, Switzerland, Czechoslovakia, Russia, Peru, Chile, Brazil, Jamaica, and Trinidad. Of fifty-four countries of the world twenty-six have adopted the calendar year, sixteen the year ending 31st March, and twelve the year ending 30th June. The selection of the financial year, and the fixing of the date of the presentation of the Budget to the legislature, are determined by administrative convenience. Accuracy in forecasting the revenue of the coming year and finally estimating the receipts and expenditure in the preceding year, are of importance. It was on this account that the Chamberlain Commission in regard to India suggested that the question of the calendar year should be considered or the commencement of the year from the 1st of November. The provincial governments were against the

¹ Cf. the author's *Indian Finance and Banking* (London, Macmillan), p. 328.

change and commercial circles were divided in their opinion, and the Government of India decided in 1923 not to alter the date.¹ Another point to remember is that the sanction of the legislature should be secured in time for raising taxation and authorising expenditure, and these two considerations should mainly govern the selection of the dates.

France makes a distinction between the fiscal year and the fiscal period (*l'exercice*).² The fiscal year corresponds to the calendar year, and the annual finance report contains only an incomplete statement of receipts and disbursements during this period, with the opening and closing balances. It is only a memorandum of account. An *exercice* is the official accounting period also corresponding to the calendar year, but it contains all the receipts credited and the expenditure debited to the period whether they are actually paid or actually received in the twelve months or not. The accounts are thus based on payments of services in the year instead of on payments within the year. The French system of accounts distinguishes between accounts *par gestion* and accounts *par exercice*. *Gestion* accounts contain receipts and expenses during a given year, while *exercice* accounts contain receipts and expenses which, by their origin, relate to a particular year irrespective of the date at which they were collected or paid. The *gestion* accounts are closed on the last day of the Budget year (31st December), while the accounts *par exercice* remain open until 31st March following the end of the year, for liquidation of liabilities (issue of pay vouchers), until 30th April for payment of liabilities and collection of claims, and until 31st July for final adjustment. Expenditure incurred but not liquidated or paid on the dates just indicated is transferred to the account of the current year under a separate heading, "expenditure on closed budgets". The publication of closed accounts is often much delayed. The accounts, for example, for

¹ See Resolution of the Government of India in the Finance Department, No. 83 F.D., dated 18th January 1923.

² Vide Plazinski's translation of *René Stourm's Budget* (New York, 1917, D. Appleton & Co.). This is a classical work on matters connected with the Budget. His discussion on the French system will be found on pp. 115 and ff. Cf. also *The Financial Administration of Great Britain* (Willoughby, Willoughby and Lindsay, 1917, D. Appleton & Co.). See pp. 323 and ff., *Royal Statistical Journal*, 1866. Willoughby, *The National Budget System, with Suggestions for its Improvement* (Baltimore, 1927); Buck, *Public Budgeting* (New York, 1929); Buchholze, *Rechnungswesens in Reich, Staat und Gemeinde* (Mannheim, 1924).

the *exercice* of 1918 were not finally closed even in 1923. The French method regards each year as possessing a personality of its own, renders comparison between different years easy and accurate, and attempts to show the real revenue and expenditure of the year, taking into account not merely the Treasury balances but also the amounts transferred to local disbursement officers but unexpended by them. It tries also to show how much of the revenue and expenditure is due to permanent and temporary causes. The main defect, and it is an important defect, in the French system is the delay in the closing of accounts. Some writers appear to hold that this method of accounting is the ideal one, and they censure Governments for not introducing it on the ostensible reason of avoiding more labour for officials. There is, however, as in most matters, another side to the question. In the first place, on the 31st of March any unspent appropriation in accounts closing on that date lapses. It is true that there is a tendency to spend up to these appropriations in some departments by a rush of expenditure in March. This can be obviated by a strict system of control by which the appropriation would not be allowed unless the amount is entirely and genuinely required. Cases have come to light when railways have bought railway sleepers and large quantities of stores necessary in order to avoid these lapses. These are in most countries not large in comparison with the total appropriation, but nevertheless they deserve to be carefully watched. The main objection to the French system is the unreasonable delay which occurs before the *exercice* is complete, a period which may extend to five years, and when complete figures are available their value is not so much greater than the ordinary receipts and expenditures used in other countries. In France there is the memorandum which corresponds to the accounts in other countries ; but it does not, of course, give details as in the *exercice*. One writer¹ suggests that most countries could follow the French method by taking accrued assets and accrued liabilities, as in the case of corporations, and close the accounts within a period of eight or nine months after the end of the financial year. There is much to be said in favour of this. At the same time there is the simplicity of the British, American, and other systems. For Governments the object of accounts is not identical with that of corporations,

¹ Adams, *The Science of Finance*, p. 206.

since Governments simply wish to know how much has been spent and how much is on hand, and not so much their total assets and their total liabilities.

THE CONTENTS OF THE BUDGET

6. The next question is whether receipts and expenditure should be gross or net, and to what extent detailed heads of expenditure should be shown. If gross figures are shown, all transactions will ordinarily be placed before the legislature, and serious scandals avoided. On the other hand, if gross figures are given there will be a tendency to swell unduly certain heads of expenditure and income, *e.g.* those connected with commercial services. Where the expenditure in the revenue-yielding departments is low and receipts in the spending departments small, it is the net figures that are of importance. On balance it is preferable to show gross figures, except perhaps in the case of commercial concerns where net figures may be given in the Budget proper with the gross revenue and expenditure data in the form of an appendix. It is preferable to have swollen and exaggerated income and expenditure rather than to avoid showing gross figures, as the vote on the Budget would in these circumstances be considerably impaired, and the more facts placed before the legislature, in the long run the better for the country's finance. Up to the year 1854 revenue departments in Great Britain did not put before the House of Commons detailed estimates, charges of collection being deducted by each department from the gross collections. A resolution of the House of Commons dated the 30th of May 1848 condemned this method. The whole of the revenue derived from taxation after the deduction of payments for drawbacks, bounties, repayments, and discounts is now credited to Government account, *i.e.* paid into the Exchequer, and the cost of the revenue departments is included in the annual estimates.¹

The Budget should be comprehensive, intelligible, and accurate. The heads of revenue and expenditure should be so classified to enable the legislature to discuss all questions of policy and public interest without difficulty, and to record their vote without prejudicially affecting other items of revenue and

¹ May, *Parliamentary Practice*, p. 447, 12th edition (London, Butterworth & Co.).

expenditure. The classification of the heads should be permanent, and no change effected without ample notice, otherwise the real position of the Budget will not be understood. Governments do not ask for more than they require. The Finance Member in the Indian Legislative Assembly said on the 22nd of September 1921 : "I have in my department men who, if I would allow them to do so, would be capable of putting up a Budget which would easily defeat the scrutiny and defy the criticisms of the House. They could conceal among the innumerable items which go to make up one Budget a liberal provision of reserves that the House would never detect, and which would relieve one of the embarrassing necessity of having subsequently to produce demands for supplementary grants. But, sir, this is not the spirit in which we frame our Budget. We frame our Budget with the deliberate intention of asking the country for only so much as we really need to spend."¹ It is unwise to have a system of separate Budgets, as this interferes with the unity of the Budget and precludes a clear grasp of the financial situation as a whole. Thus in the French Budget all fiscal items are not included outside the general Budget, nor are items in the "caisse d'amortissement" (Law of 7th August 1926) and the "Social Insurance Law" (5th April 1928). The "Services spéciaux du Trésor" are not linked in any way with the general Budget, and thus in several directions it is difficult to obtain the true surplus or deficit in any year in the French budgetary system. It may, as stated elsewhere, be possible to give a separate Budget for a very important commercial head such as railways in order to facilitate the running of the department on strict commercial lines. In regard to the question whether any special income should be assigned for any special expenditure, the general principle to be followed is to meet expenditure from general revenues and not to earmark any particular source for a special item of expenditure.

SUPPLEMENTARY BUDGETS AND ESTIMATES

7. We have condemned supplementary Budgets since they upset the financial period and waste the time of the legislature. These may be used on rare occasions as in September 1931 in

¹ *Legislative Assembly Debates*, vol. ii. p. 845.

Great Britain and in India in November of the same year, when these countries slipped off the gold standard and the economic blizzard of that year required new Budgets so that new taxation could be imposed to meet changed conditions. Although under supplemental Budgets new facts are brought to the light of the legislature, and corrected if necessary, they produce a general feeling of insecurity in the administration, such as to outweigh all advantages that may be urged in their favour, except in cases of emergency such as the outbreak of a war. In an emergency national policy is to improve the balance of trade and to equalise the yield of taxation with a normal recurring expenditure of the Budget. The methods to achieve this must be such as to increase rather than to diminish output, and hence to increase the national income and the yield of revenue whilst maintaining the principles of social justice.

With supplementary estimates or grants, or, as they are termed in France, *crédits additionnels*, or in America, "deficiency bills", the case is otherwise. A supplementary estimate may be either for a grant to a service already approved or for a grant of new expenditure that has arisen since the presentation of the Budget to the legislature. "The need", says May, "for a supplementary grant to an existing service is not infrequently caused by the system in force to ensure the control of Parliament over public expenditure. To provide for the early presentation of the annual estimates, the departments are obliged to compute in the month of November their anticipated expenditure for the ensuing financial year, dating from the coming 1st April. Fallibility must attend calculations which range over sixteen months in advance; and as too large a demand for money is a grave departmental error, the official tendency is to make the demand too small. If the lesser error occurs, to avoid the still greater evil of excess expenditure, recourse of necessity must be had to a supplementary grant."¹ It may be sometimes necessary for departments to apply for excess grants, having expended their appropriations of the previous year. The British House of Commons, on the 30th of March 1849, resolved that "when a certain amount of expenditure for a particular service has been determined upon by Parliament, it is the bounden duty of the department which has that service

¹ May's *Parliamentary Practice*, 12th edition, p. 452.

under its charge and control to take care that the expenditure does not exceed the amount placed at its disposal for that purpose".¹ Exceptional demands are met by votes of credit, which are ordinarily voted before the expenditure is incurred. We have seen that the total amount of votes of credit during the War voted by the British House of Commons amounted to £8742 millions. They are used when the extent of the service is unknown. Like other grants, they are available only during the financial year in respect of which the grant is made. Financiers have from time to time condemned supplementary credits. Gladstone, for example, said, "It is a sound principle that one, and only one, estimate of national expenditure should be laid before Parliament during each session; for to render Parliamentary control effectual it is necessary that the House of Commons should have the money transactions of the year presented to it in one mass and in one account". They tend to make for incorrect estimates, and above all are sometimes used to escape the vigilant scrutiny of the legislature in the original Budget. "The practice of deficiency bills", Adams has noted, "tempts the administration to withhold a complete statement of its needs in the original estimate for fear its estimates may be cut down. The officers of the executive department may have greater confidence in the willingness of the legislature (or, what amounts to the same thing, in their ability to coerce the legislature) to grant supplemental credits than to vote the entire amount which they recognise as necessary in the original appropriation. This, of course, is an improper method of procedure and a perversion of the theory of deficiency bills, which should be strictly limited to the correction of legitimate or inevitable errors in the original estimates. The legislature, also, or rather the party in power, finds itself exposed to a similar temptation. Suppose, for example, an important election between the voting of the original appropriation and the time when deficiency bills are presented. What is to hinder the legislature from curtailing the appropriations in the regular Budget in order to make a show of economy before the public? Such a policy must of course be followed by unusual appropriations in the form of deficiency bills, but the election meantime has taken place and the party has been

¹ *Ibid.* p. 453.

returned to power. This is both an undignified and a dishonest procedure.”¹

EXTRAORDINARY BUDGETS AND EXTRAORDINARY EXPENDITURES

8. Budgets are sometimes divided into ordinary Budgets and extraordinary Budgets, but these terms are used in widely different senses in various countries. Extraordinary Budgets are used mainly to finance war, war preparations, or large capital programmes such as those for railways. It is usual to confine the term “extraordinary expenditure” to new capital expenditure which is met from loans, and the cost, therefore, of amortisation is shifted to future years. Germany originally included in the extraordinary Budget only capital expenditure. This, however, included expenditure on naval armaments and on military works. Since the War, German extraordinary expenditure has been applied to reparations and to investments taken in a wide sense, while extraordinary revenue includes the proceeds of loans and other funds such as interest on railway bonds and industrial debentures and transfers from the general Budget. A distinction is also made in ordinary expenditure in the German Budget between “permanent” expenditure for the continuous requirements of the administration and “one-time” expenditure, non-recurring or expenditure of which the recurrence is at long intervals or is uncertain. In France and Belgium extraordinary Budgets include both capital expenditure and other expenditures of a non-recurring nature, although, especially in times of stress, items of a recurring nature are apt to be included. Extraordinary Budgets in France were nominally abolished from 1922, but they are still in use and to the unwary in French finance are misleading when the real surplus or deficit is to be calculated. In Japan extraordinary Budgets include the extraordinary revenue such as the proceeds of sales of State property, loans, and receipts from local contributions towards the expenses incurred by the State for the benefit of certain prefectures, transfers from special accounts, while extraordinary expenditure includes expenditure on new and non-recurring items.

¹ Adams, *Public Finance*, p. 185. This has been modified by the creation of the Budget Bureau in the Treasury by the Budget and Accounting Act, 1921.

It is better to disregard altogether the distinction between ordinary and extraordinary Budgets and between ordinary and extraordinary revenue and expenditure. In the British Budget there is no distinction between ordinary and extraordinary expenditure and the Budget includes all fiscal items. The nearest approach to an extraordinary Budget or capital account in the British financial system is capital expenditure provided not by a vote of the year but by a special Act authorising the issue of a total sum from the Consolidated Fund, such expenditure being usually outside the Budget. It is met either from a portion of a realised Budget surplus (which can always be diverted from its statutory purpose for the redemption of the National Debt by a special clause in the Finance Act) or by a special borrowing clause. It is difficult to strike a proper line of division between ordinary or permanent and non-recurring or extraordinary items. Expenditure, for example, in connection with earthquakes in Japan and Italy or famines in India may be regarded as a fairly regular item, and there is, therefore, no clear-cut division between the two. The Cour des Comptes of France has time and again pointed out the evils of extraordinary Budgets—especially the practice of charging regular expenditure to such Budgets. Another objection to extraordinary Budgets is that they open the way to subterfuge and offer temptation to abuse. They tempt a Government to balance its Budget by trick devices, by placing outside the general Budget items which should be included. The concept of an extraordinary Budget is dangerous for another reason. It leads the general public to think that Governments can meet such expenditure by the proceeds of loans instead of from taxation. It is, therefore, better to avoid altogether the slippery term “extraordinary Budget”. All fiscal items should be included without exception in the content and scope of a Budget so that a deficit may be at once seen and a nation be prevented from living beyond its income. A deficit itself may not be a very serious matter when unexpected expenditure is imperatively necessary during the currency of the financial year, expenditure unforeseen when the Budget was passed. What is all-important is not so much a deficit at the end of the year but the measures taken to meet that deficit. If a country fails to take steps to balance its Budget, then naturally grave doubts arise as to its financial stability. No country must live beyond

its means, *i.e.* on its capital. On the other hand, if the estimated revenue shows a large surplus over the estimated expenditure, taxation may be reduced to the extent of the amount of the surplus realised in the previous year.

CHAPTER XXXIX

THE LEGALISATION OR VOTING OF THE BUDGET

CONSTITUTIONAL CHANGES AFTER THE WAR

1. THE next stage in the history of the Budget is its legalisation, and this depends to a large degree on the constitutional law and custom of the country concerned. The conception of the Budget as a central instrument of financial administration is, as we have seen, a comparatively recent development. The early struggles of the legislature were on taxation or revenue rather than on expenditure. But gradually legislatures came to control both. It is not often realised how complicated a business the voting of a Budget is. This may be illustrated by referring to the publications connected with the Budget in the legislature. In the United Kingdom, for example, there is the Budget Speech with the Financial Statement of revenue and expenditure accompanying it. There are five large volumes of estimates, one each for the Civil Service, revenue departments, the Navy, the Army, and the Air Force. There are also four volumes of Appropriation Accounts, one each for the Civil Service and revenue departments, the Navy, the Army, and the Air Force. In addition, there are returns relating to revenue and expenditure, such as the Memorandum on Present and Pre-War Expenditure, the Public Social Services return, and the Finance Accounts of the United Kingdom for the year. There are returns relating to the National Debt, Sinking Funds, Local Loans, the Civil Contingencies Fund, the Treasury Chest Fund, the Development Fund, and the Post Office Savings Bank. All these are Parliamentary publications. In the United States the Budget document itself is a bulky volume of about 1500 pages published by the Bureau of the Budget. Part I. contains the Budget Message of the President, the general financial statements, and the estimates of expenditure and receipts. Part II.

contains detailed expenditure estimates classified by Government departments. There are, in addition, Treasury and Congressional documents relating to finance. In France the document referred to as the Budget is the "Projet du budget", and it is usually in three volumes and contains approximately 2500 pages. Volume I. contains the financial statement (*Exposé des motifs*) with an explanation and text of the proposed laws (*Examen des articles de la loi des finances and projet de loi*), and also the estimates of expenditures and revenues. Volumes II. and III. contain detailed expenditure estimates. The final Budget Law as enacted by the legislature (*Loi fixant le budget*) is published in the official gazette (*Bulletin officiel*). In Germany the Budget is published in two volumes. Volume I. contains the Budget Laws as voted (the *Gesamtplan*) with Parts I.-VIII. of the "Einzelpläne". Volume II. contains "Einzelpläne" IX-XX. These volumes cover approximately 1000 large pages. In Italy the information on the Budget is published in several volumes and extends to many thousand pages. The Speech of the Minister of Finance (*Nota preliminare generale*) is published as a parliamentary document. The text of the proposed laws appears in separate volumes for each of the thirteen Ministries and each volume contains also expenditures. The volume for the Ministry of Finance includes all revenue items.

In order to arrive at the connecting principles it is necessary to indicate the outstanding features of the more important systems. Although the procedure in different countries differs, there are certain general rules generally applicable to the legalisation of the Budget. There are several problems such as the initiation of money bills, the annual voting of the Budget, reappropriation or powers of *virement* granted by the legislature, reserve funds, the powers of the two Chambers (such as the House of Commons and the House of Lords in the United Kingdom of Great Britain and Northern Ireland, the Chamber of Deputies and the Senate in France, and the House of Representatives and the Senate in the case of the United States), and finally the veto and the restoration in certain cases of grants in the Budget. All these questions require consideration, and the procedure in some countries has almost become a meaningless ritual which goes on year after year and generation after generation. Occasionally the financial machine is renovated and brought up to date, as in

the classic instance of the American Budget and Accounting Act, 1921. The Budget as it emerges from the executive must be unified, and at the same time be a detailed system giving full information on the country's finances. It must be clear, timely, full, and accurate.

PROCEDURE IN DIFFERENT COUNTRIES

2. As is well known, the power of voting the Budget has grown gradually. The famous 12th Article of the Magna Charta provides that "no scutage or aid shall be imposed in the kingdom, unless by the Common Council of the realm, except for the purpose of ransoming the king's person, making his first-born son a knight, marrying his eldest daughter once, and the aids for these purposes shall be reasonable in amount". Clause VI. of the *Confirmatio Cartarum* of 1297 provides that "for no business henceforth will we take such manner of aids, tasks, nor prises, but by the common assent of the realm, and for the common profit thereof, saving the ancient aids and prises due and accustomed". The Stuarts asserted the divine right of kings, and attempted to deny the right of the Commons to vote the Budget. In 1626 an Appropriation Act legalised all previous appropriations. Charles I. attempted to raise forced loans, but the Petition of Right solemnly declared that no tax should be levied without the consent of the nation, and condemned forced as well as voluntary loans to the Crown. The levy of ship money and the famous trial of Hampden are too well known in English history to be described here. With the Revolution, however, of 1688 the principle of Parliamentary control of the purse triumphed. "Henceforth shall no man be compelled to make any gift, loan, or benevolence, or tax, without common consent by Act of Parliament". The Crown, in other words, has no prerogative at all to impose or change taxation independently of Parliament. The right of the representatives of the people to control the purse has never since that time been contested.

The result to-day is that the British Parliament, although in no sense an executive authority, exercises control (1) by legal restrictions, which prevent the Crown or its Ministers from imposing any charge without the consent of Parliament, either in the form of taxation or expenditure on loans, and from maintaining a

standing army in time of peace ; (2) by the doctrine of the Constitution, by which supplies are granted annually by the House of Commons, this supply necessitating statutory sanction each year ; (3) by the rule of the Constitution by which Ministers of the Crown are held responsible to Parliament for any act done by them in their ministerial capacity or for any advice tendered by them to the Sovereign ; (4) by means of the rule by which supply granted must be appropriated to the particular purpose for which it was granted ; (5) by the presence of Ministers in Parliament, so that their actions can be examined and criticised ; and (6) by other means, *e.g.* Parliament may be supplied with information, such as by questions and answers,¹ by royal commissions or committees, and by "command papers", which, with the exception of the annual estimates which are printed by the order of the House of Commons, are printed on the authority of the department presenting them. In each House command papers are presented without any formality by being laid on the table by the Minister responsible for them, and during a recess these papers may be presented to the House of Lords by delivery to the Clerk of the Parliament or to the House of Commons by delivery to the Librarian of that House, in accordance with the standing orders of both Houses. It is possible for either House,

¹ It is obvious that questions and interpellations on financial questions are of importance. The earliest recorded instance of a parliamentary question occurred in the House of Lords on 9th February 1721, and the practice was only formally recognised on 29th April 1830 when the Speaker of the House of Commons ruled "that there is nothing in the orders of this House to preclude any member from putting a question and receiving an answer to it", and this method, "though not strictly regular, affords great convenience to individuals". Questions appeared on the Order Paper for the first time in 1849 and in 1854 appeared Rule 152, that questions were permitted to be put to Ministers on public affairs before public business was entered upon, and to other members relating to any Bill, motion, or other public matter in which such members were concerned. Questions may be debated in the House of Lords but not in the House of Commons, though a member in the latter may give notice that he will raise the matter on the motion for the adjournment of the House, which can be made only immediately after Questions if it receives the assent of not fewer than forty members, and after the Speaker has decided that it is "a definite matter of urgent public importance". The matter must be both urgent and definite. As the Executive in the United States is not responsible to the legislature (*i.e.* to Congress), questions have no place. They have, however, a place in those countries which are modelled on the United Kingdom such as Canada and India. In Switzerland questions and interpellations are permitted. In France interpellations, *i.e.* interrupting the order of the day by demanding an explanation from the Minister concerned, are very frequent and lead on occasions to ministerial crises.

by means of an address to the Crown or of an order of the House, to obtain from any department information connected with the work or administration of such department. In the House of Lords a motion for papers is often laid for the purpose of debate upon a fit subject of public interest, but in the House of Commons this is seldom done. A motion for a return or for information upon any subject may be refused if the making of such return or the giving of such information is considered to be inadvisable in the public interest or involving unreasonable labour or expense. Although it is not possible for any member of the House, except a member of Government, to propose expenditure, he can move a resolution to the effect that public money might profitably be expended upon purposes specified in the resolution, and if the House agrees to the motion, it thereby commits itself to a general approval of such an outlay. A private member cannot, however, move that a specific sum be granted for a special purpose, as it must emanate from a Minister of the Crown.¹ This is a great safeguard of the taxpayer against what Anson calls "the casual benevolence of a House wrought upon by the eloquence of a private member, against a scramble for public money among unscrupulous politicians bidding against one another for the favour of a democracy. But the rule is not law. Like all other resolutions or standing orders of either House, it is a self-imposed rule, made by a public body for the guidance of its procedure."² This self-denial on the part of the House of Commons is not based on statute but merely on the resolution of the House, which could be rescinded at any time. But the House has found the wisdom of the Standing Order which is beyond argument. It is the Executive that is responsible for the Budget balance and for the finances of the country. A recommendation by the Crown under this Order is usually communicated by the responsible Minister verbally, or it may be communicated under the sign-manual. The most usual way is for a Minister simply to touch the document, as it is introduced, with his finger by leaning

¹ Standing Order No. 66 of the House of Commons provides : "This House will receive no petition for any sum relating to the public service, or proceed upon any motion for a grant or charge upon the public revenue, whether payable out of the consolidated fund or out of money to be provided by Parliament, unless recommended by the Crown".

² *Law and Custom of the Constitution*, vol. i. p. 272 (Clarendon Press, Oxford, 1909).

forward in his place on the front bench in the House of Commons. This limitation of financial initiative protects members of the House of Commons from improper pressure by their constituencies, the House itself against appropriation of public funds for the benefit of individual constituencies, and, lastly, the taxpayers. The House can make its will felt on the Government by not agreeing to the Government's programme ; it can reduce the provision for any service or services if it wishes. This is the detailed veto in the course of votes of Supply. Its power in this way is negative. But it also can not merely reduce but indirectly increase expenditure. It can refuse a demand by reducing the vote merely by a nominal amount or refusing to pass it altogether on the ground that it believes the provision to be inadequate. The Government, then, can bring in a revised proposal, and when the House in this way dictates an increase of expenditure its power is the reverse of negative or it is indirectly positive. The House can insist on a change of Government. This is in practice effected by a vote of want of confidence, but such a vote ultimately rests upon the power of withholding ways and means. This is the general veto as opposed to the detailed veto. In Canada and the other Dominions and in the Government of India Act, 1935, checks similar to those in the British Constitution are in force. In accordance with Section 54 of the British North America Act, "it shall not be lawful for the House of Commons to adopt or pass any vote, resolution, address, or bill for the appropriation of any part of the public revenues or of any tax or impost, to any purpose that has not been first recommended by the Message of the Governor-General in the session in which such vote, resolution, address, or bill is proposed". All financial legislation must be recommended by the Crown, and it is based upon estimates carefully in advance under the direction of the Minister of Finance.

When Parliament meets for the new session towards the end of January or early in February and immediately after the Speech from the Throne, which is delivered as soon as the House meets, the Crown (or Government) informs in general terms the House that the estimates for the expenditure will be laid before it in due course. Proposals for expenditure on the part of the Crown as the head of the executive come before the House in the form of estimates which are presented by the Ministers responsible for

the departments requiring money. The House then must go into Committee of Supply for the purpose of deciding upon the expenditures of the year, and afterwards into Committee of Ways and Means for providing funds to meet that expenditure. Each Committee is a Committee of the whole House¹ under a Chairman instead of the Speaker, and the House, it is to be remembered, consists of no fewer than 615 members including the Speaker, a large number for a Committee. This procedure has the advantage that in committee discussion is much more informal and a member may speak more than once. The expenditure is made up of the Consolidated Fund Services, expenditure established by permanent statutes requiring no annual enactment, and expenditure on supply services which, on the other hand, requires annual authorisation of Parliament. The business of the Committee of Supply is to agree to the votes required as shown in the estimates for the service of each department. The Committee of Ways and Means approves the issue from the Exchequer of the money required to meet that expenditure. It thus makes supply effective. This procedure prevents the House being taken suddenly or unawares in regard to proposals for expenditure. A standing order of the House makes this precaution doubly certain, as it is necessary to adjourn at least once before the expenditure is considered in committee. Standing Order No. 71 reads: "If any motion be made in the House for any aid, grant, or charge upon the public revenue, whether payable out of the Consolidated Fund or out of moneys to be provided by Parliament, or for any charge upon the people, the consideration and debate thereof shall not be presently entered upon, but shall be adjourned". In the first fortnight of the session after the House has met, the Army, the Navy, the Air Force, and the Civil Service estimates for the next financial year from 1st April are submitted to the House, the Civil estimates by the Financial Secretary to the Treasury, and in the case of fighting services by the First Lord of the Admiralty, the Secretary of State for War, and the Minister for Air respectively. A motion is made before the House goes into Committee of Supply to discuss the estimates to the effect "that Mr. Speaker do now leave the chair". On the principle that grievances precede supply, a debate of general character on some questions of topical interest is permitted, and only one vote is

¹ Standing Orders Nos. 67 and 69.

taken on the debate. If the mover of the first motion does not divide the House, then the next motion in order of the ballot is considered ; but when a division takes place the Speaker leaves the chair. This debate, which could be covered subsequently in committee, is much out of date and could be dispensed with without difficulty, in spite of the fact that it gives a private member one of the rare chances of bringing a matter of importance before the House. Members ballot for precedence for their motions, and the debates are limited to the four occasions on which the Speaker is moved out of the chair for the four classes of estimates, the Civil Service, Army, Navy, and Air Force.

The Committee of Supply can vote the grant or reduce it. It cannot put any condition in regard to it or alter its destination. When the Committee has finished its work, usually after several adjournments, there follows the Report stage on which the whole matter can be again debated. After this second debate the House approves the resolution which it has itself made as a Committee of the whole House. There are about 150¹ votes in Committee of Supply, and in order that the discussions may not continue for too long a time, they are limited by the rules of the House to twenty days. On the nineteenth day all outstanding votes have to be passed in committee, and on the twentieth day the Report stages have to be completed. Between one-third and one-half of the total expenditure of the year cannot be considered at all as these are consolidated fund services, and of the supply estimates outstanding on the nineteenth day these must be voted without any debate or criticism in the space of an hour, when the guillotine falls, a weakness which is frequently referred to by critics of the present system, who regard the reconsideration of votes on Report as a sheer waste of time when there are so many votes that cannot be discussed. Under the present rules, not more than twenty days, being days before the 5th August, are allowed for the consideration of the annual estimates, including votes on account and procedure in Committee of Ways and Means and on Reports, to which additional time not exceeding three days before or after

¹ A vote is divided into sub-heads and may contain even thirty or forty or only two or three sub-heads. The number depends not on the magnitude of the vote but on the variety of the sub-heads charged to it and the requirements of financial control. The large vote of Old-Age Pensions, for example, has only two sub-heads, one for pensions and the other for expenses of local pensions committees.

the 5th August may be allowed under the orders of the House when any matter of special importance has been discussed in Committee of Supply during the sittings.¹ The votes for discussion are usually settled by the Whips of the House concerned, so that each party may have an opportunity of discussing matters of interest. When the Committee of Supply has completed its work the question of providing the money out of the Consolidated Fund, into which, as we have seen, the whole public revenue is paid, arises, and for this purpose the House now sits as a Committee of Ways and Means.

Votes on account are necessary to meet the immediate needs of the coming year of each of the chief heads of the service, the Civil Service, the Army, the Navy, and the Air Services. In the case of the Navy and the Air votes on account, a few of the detailed votes are taken, and the amount sanctioned may be used towards the various votes concerned. The sums granted on any one of the Admiralty and Air Ministry votes can thus be used for any other vote within the main vote. Ultimately the expenditure must be in accordance with the Appropriation Act. It is customary, therefore, in the early part of March to take the votes on pay for the Navy and the Air Force and one or two others, so that there is enough money to carry on until the Appropriation Act is passed. The Army now takes a vote on account, as is done in the case of the Civil votes. The Consolidated Fund bills are the bills which provide out of the Consolidated Fund the lump sums voted in order to make good the supply for the ensuing financial year. The Comptroller of the Exchequer, by section 15 of the Act of 1866, can permit issues *if granted by Parliament*, and a Consolidated Fund Act has, therefore, to be rushed through all its stages before 1st April to enable the Government to draw money from the Exchequer to complete the service of the year about to end and to provide sums for the ensuing financial year. The Consolidated Fund Act is not an appropriation Act, as it does not distribute the sum granted amongst the votes. It does not appropriate the grants item by item. There may be several Consolidated Fund bills during a session. They give statutory authority to the resolutions for the issue of money out of the Consolidated Fund and contain only the total sum required.

¹ The period of twenty days excludes the days set aside for supplementary estimates and for the "grievance" debates.

They also give power to the Treasury to borrow any sum usually up to the whole amount to be issued. The House may then proceed at its usual pace after the beginning of the financial year to consider supply. The House will grant on account amounts equal to the extent required for four or five months, which enables the Appropriation Act to be passed through all its stages.

The Committee of Ways and Means is appointed "for raising the supply to be granted to His Majesty". The Committee of Ways and Means meets also to hear and to debate the proposals of the Chancellor of the Exchequer laid before the House usually in April, and it is at this stage that the Chancellor opens his Budget and explains the financial policy of the ensuing year. The Budget is comprehensive and includes departments which have receipts in excess of their expenditures, like the County Courts which support themselves. In order that the House of Commons may have these under review it is customary to put down an appropriation in aid which will meet so much of the receipts as will meet all the expenditure except a nominal amount, say £10 or £15. This nominal sum then appears as the net amount or token vote to be voted in Committee of Supply. The Chancellor's figures showing the balance of surplus or deficit on the 31st March (the accounts close at 4 P.M. on that day) are known on the 1st of April and there is no reopening of a Budget such as in France. The simplicity of this system is its great virtue. There is always, of course, revenue received by the Government which has not yet reached the Exchequer, and there must be a considerable outstanding liability in the form of cheques issued but not yet cashed. On the whole the difference between the Exchequer receipts and issues on the one hand and the true revenue account disclosed by the ultimate audit on the other hand, taking one year with another, is not large; and the simplicity and timeliness of the present system, therefore, are of very great value. During the War and some years afterwards, when huge commercial accounts were included, the difference was temporarily exaggerated. If the estimated revenue exceeds the estimated expenditure the surplus may be used for various purposes, such as to redeem debt or to reduce taxation. If more funds are required there will be new taxation. The Committee of Ways and Means immediately after the Budget speech passes resolutions approving of the new proposals of the Chancellor of

the Exchequer and agreeing to their coming into immediate effect. When the resolutions go through the Report stage in the House they are afterwards embodied in the Finance Bill of the year, which has to go through the regular course of a bill before it becomes law. The Finance Bill is the statutory basis of that part of the revenue which must be enacted every year. By the Provisional Collection of Taxes Act of 1913 it is enacted that where a resolution is passed by the Committee of Ways and Means providing for a change in taxation, and if the resolution contains a declaration that it is expedient in the public interest that the resolution should have statutory effect, the resolution has the same effect as if it were an Act of Parliament. It is, however, for a limited period only and ceases to have statutory effect if not agreed to on Report within ten sitting days after the resolution was passed by the Committee. The bill confirming this must be read a second time within twenty days of the passage of the resolution and the statutory effect expires after four months. This Act applies to customs, excise, and income tax alone. It provides against the importers and manufacturers forestalling any new changes in taxation. The sums voted in the Committee of Ways and Means must never exceed the sums voted in Supply, and therefore the final authorisation of a Ways and Means resolution in the Report stage can only follow the Report stage of the Supply resolutions. It is interesting to note that a defeat in the Committee of Supply must usually involve a Government's fall, but in the case of the Committee of Ways and Means there is an understanding that the Government need not consider questions of taxation (*i.e.* what comes before the Committee of Ways and Means) as a question of confidence. They may reconsider any particular method of finance which they have proposed, provided it applies to taxation only, and not to questions of expenditure. After the estimated expenditure has been approved (1) in Committee of Supply, (2) reapproved on the Report of Supply, (3) approved a third time in Committee of Ways and Means, and again (4) on the Report of Ways and Means, it has to become law, and in this connection there arises the Appropriation Act, which has to be presented to the House of Lords for their assent and then to the Crown, as the House of Commons cannot give its proposals the force of law by means of its own resolutions. The bill must pass through the regular stages of the first reading,

second reading, committee, report if necessary, and a third reading in both the Lower and Upper Houses, and then it must be presented for the Royal Assent.¹ The Finance Bill and the Consolidated Fund Bills, including the final Appropriation Act, are money bills and are sent up to the House of Lords with the Speaker's certificate that they are money bills, as required by the Parliamentary Act of 1911, and if not agreed to by the House of Commons within a month, are presented to His Majesty and become Acts of Parliament. At the end of the session or before the summer adjournment the Appropriation Act is passed. There is first of all the Finance Bill dealing with taxes such as the income tax and other taxation (the tea duty²) which need re-enactment annually, and, secondly, there is the Appropriation Bill which follows in the wake of the Consolidated Fund Bills passed earlier in the session. The Appropriation Act appropriates to each vote a sum as voted in Supply and authorises the Treasury to issue a sum equivalent to the aggregate of the sums granted and gives the Treasury borrowing powers. The schedules to the Appropriation Act set out the votes of the estimates in detail together with the amount of minor sums which are to be collected by the departments. The second reading to this bill gives an opportunity of raising any matter connected with the administration, and when the Royal Assent is given the financial work of the year may be said to be complete.³

¹ The requirement that all bills must have three readings cannot be explained historically as it goes back to the very distant past. This rule, however, appears in the legislatures of all Anglo-Saxon countries, many Continental countries, and Japan. English procedure, probably as a result of Dumont's *Tactique des assemblées législatives* (2 vols., Geneva, 1816), has been copied by many countries, especially by France and Germany. The United States' procedure has been based on English practice where the colonial assemblies copied the House of Commons' procedure. The influence of this procedure upon Congress was largely through the *Manual of Parliamentary Practice*, by Jefferson, who as Vice-President and *ex-officio* President of the Senate drew up the procedure freely upon English authorities, especially *Hatsell's Precedents*. The procedure in the House of Commons was largely settled by the end of the seventeenth century. The student of public finance will find points of similarity, traceable to the fact that the procedure of many legislatures was copied from the British Parliament, the mother of Parliaments.

² The tea duty was discontinued in 1930–31 and 1931–32, but a duty of fourpence per lb. was levied from 1932–33, special preference being given to Empire-grown teas. When the tea duty alone among indirect taxes and the income-tax among direct taxes are re-enacted, the revenue system for the coming financial year is complete.

³ If any further supply is voted after the Appropriation Act is passed in August, a further Appropriation Act is required before the end of the session.

At the beginning of the new session the House of Commons also takes into consideration supplementary estimates for the current financial year, which pass through all the stages of Committee and Report, both in regard to Supply and Ways and Means. These supplementary estimates are usually included with the Ways and Means resolutions which cover the vote on account and the Navy and the Air Force pay votes. It is the Consolidated Fund Act which gives the supplementary estimates statutory authority. When there is an autumn session of the House, supplementary estimates are submitted in order that the House may not be burdened with this when heavy financial work takes place towards the end of the financial year, viz. in February and March. Supplementary estimates are unavoidable as the Budget has to be prepared often well in advance of the actual expenditure. Nevertheless these must be scrutinised by the House of Commons with care if the House is not itself to be considered as a mere spending department. Supplementary estimates, as pointed out in the previous chapter, weaken budgeting and are to be avoided as far as possible. The House of Commons in very grave emergencies as in war grants a vote of credit, a sum without details as regards how it is to be spent, as the procedure of supplementary estimates would be too slow a procedure. It must be considered in a Committee of the whole House and confirmed by the next Consolidated Fund Bill or by a special bill.

It will be seen that in regard to the voting of the Budget there is still a good deal of unnecessary procedure which centuries ago may have been necessary when the check was on the Crown and not on the Government of the day. The financial armoury of the House of Commons now requires refurbishing, especially from the fact that one-third to one-half of the estimates do not come up before the House of Commons for detailed criticism. A writer has well pointed out the obsoleteness of the procedure thus : "Time much needed to do the work of the twentieth century is wasted on precautions against dangers passed with the seventeenth. The meaning and utility of much of the ritual are now no greater than that of the annual search for gunpowder in the cellarage. For this there is one change in the course of our history that is chiefly responsible. The years during which the procedure was being worked out were the years of the struggle between the legislature on the one hand and the Crown on the other. The

chief care of the Commons was at first to prevent the Crown from getting money except through Parliament, and in later days to prevent it from spending money on purposes other than those for which Parliament had provided it. Their procedure was planned to act as a check on the Crown in the interest of themselves, the economists. But times have changed. The rule of Parliament is established and the power of the Crown is gone. A check upon the Executive's power over the purse is still needed by the Commons as much as ever, but the Executive upon whose power the check has to be exercised is now not the Crown but its ministers responsible to Parliament. What we need in our financial organisation in the twentieth century is that the House of Commons should direct its attention to imposing checks upon the extravagance of itself and its own ministers, and it is vain to allow an undue veneration for the sacred principles of the Constitution to conceal that from us."¹ Another criticism of the legalisation of the British Budget is that since the rules of the procedure of the House of Commons prevent any proposal for the expenditure of funds except on the recommendation of the Ministry, this limits the House mainly to matters of policy rather than to the technical requirements of the Government. In this way it may be said that the legalisation of the Budget in the House of Commons is in reality superficial as the legislature can only reduce an item or reject it altogether. The Ministry with its majority in the House of Commons can defeat as a rule any such motion. Moreover, the Consolidated Fund expenditures now vary between 30 and 40 per cent of the total expenditures, and the revenue fixed by continuous law and, therefore, escaping the Budget process also varies within the same amount. For these reasons the power of the House of Commons over the Budget is alleged in some quarters to be perfunctory.

It is sometimes urged that the Committee of Supply of the whole House is far too large a Committee to examine in detail the financial estimates, and the procedure itself makes the guillotine fall when the work is incomplete, so that a large proportion of the votes in any given year receive, as we have seen, no examination at all at the hands of the House of Commons. Nevertheless it does not follow that a vote on which the guillotine has fallen may

¹ E. Hilton Young and N. E. Young, *The System of National Finance*, 2nd edition (London, 1924), pp. 50-51.

not have been previously discussed. The Committee can neither call for papers nor examine witnesses as is done in several foreign legislatures, with the result that this committee stage of Supply is utilised chiefly for grievances and general criticism of the policy of the Government of the day. The convention that an adverse vote in Committee of Supply may be treated as one of confidence involving the fate of the Government, results in the House losing direct effective control so far as the proposals for expenditures are concerned. On the other hand, the House indirectly may and does have a considerable influence on the policy of the day. This influence could with advantage be increased to such an extent that the House would no longer in the eyes of some critics be "one of the chief spending departments of the State". A Select Committee of 1918 which based its answers on a questionnaire addressed to the Speaker, to the then Chancellor of the Exchequer, and to three of his immediate predecessors, as also to a selected number of members of the House and public servants, recommended that there should be two, or if need be three, standing committees on estimates, each committee to consist of fifteen members. The committees were to be set up at the beginning of each session. It was to be the duty of these to examine the annual estimates and supplementary estimates and to suggest to the House any economies, while strictly excluding any question of policy, which must be left to the Executive. This ought to be carried into effect with the least possible delay. In all matters of finance the House of Commons was, however, to remain finally responsible. The Committee was to have the assistance of a permanent officer whose functions in relation to the estimates would be parallel with those of the Comptroller and Auditor-General in relation to the accounts. The object underlying these suggestions was that the House of Commons should examine financial details with system and with regularity of procedure which do not obtain at the present time. The Estimates Committee was indeed set up in 1918, but only "To examine such of the estimates as may seem fit to the Committee, and to suggest the form in which the estimates shall be presented for examination, and to report what, if any, economies, consistent with the policy implied in the estimates, may be effected therein". It does not have time to do the duties given to it and it has to do without the services of a regular officer.

In the Dominions the procedure in the adoption of the Budget by the legislature is very similar to that of the mother of Parliaments. In Canada, for example, there are Committees of Supply and of Ways and Means, Appropriation Acts, and the English constitutional doctrine that the redress of grievances is to be considered before the granting of supplies is given effect to on the recommendation of the Minister of Finance "that the Speaker do now leave the chair for the House to go into Committee of Ways and Means".

After the estimates are passed through the Committee of Supply, the Finance Minister moves that the House again go into Committee of Ways and Means for the usual formal resolution of granting certain sums out of the consolidated revenue fund of Canada "towards making good the supply granted to His Majesty". These resolutions must be reported and agreed to formally by the House before the bill founded thereon can be introduced. It is not customary for the House to change to any degree the estimates, and no increase in expenditure or any new expenditure not included in the Budget is passed by the House. After the Finance Bill has been adopted by the Commons it goes to the Senate, and as in Australia, it is invariably the custom of the Senate to return the bill unamended to the Lower House. A supply bill can only be presented for the assent of the Sovereign by the Speaker of the House of Commons. This is done at the close of the session in connection with the ceremony of the proroguing of Parliament, and the Governor-General signifies through the Clerk of the Senate, in both the English and French languages, the Royal Assent in the following words : "In His Majesty's name, His Excellency the Governor-General thanks his loyal subjects, accepts their benevolence, and assents to this bill". In Canada there are no time limits on legislative action on the Budget as there have been in the case of the United Kingdom since the Parliamentary Act of 1896. If necessary, votes on account are passed if the estimates are not voted before the beginning of the period.

Under the Government of India Act of 1935 the Federal or Central Budget is laid before both Chambers and each has equal powers. Money bills cannot be introduced except on the recommendation or the responsibility of the head of the Executive, the Governor-General, and must first be placed before the Lower

House, the Federal Assembly. A money or financial bill is a bill (1) imposing or increasing any tax or impost whether local or general ; (2) authorising the borrowing of money or the giving of any guarantee by the Federal Government, or in amending the law with respect to any financial obligations undertaken or to be undertaken by the Federal Government ; or (3) declaring any expenditure to be expenditure charged on the revenues of the Federation or in increasing the amounts of such expenditure. Either chamber has the power to assent or to refuse to assent to any demand or to reduce any demand put before it by the Executive. If the Assembly refuses to assent to any demand that demand is not to be submitted to the Council of State unless the Governor-General so directs, and where the Assembly has assented to a demand subject to a reduction of the amount specified therein, a demand for the reduced amount only is submitted to the Council of State unless the Governor-General otherwise directs. In either case where the Governor-General gives such a direction the demand cannot be greater than that originally demanded. The procedure, in short, is that all demands for grants are considered first by the Lower House and subsequently by the Upper House, and the powers of each in relation to demands are identical. Any difference of opinion is solved in conference—by joint committee or at a joint session of the two Chambers. The decision of the majority of the members present and voting at a joint session is the decision of the two Chambers. The schedule specifying the grants made by the Chambers—the votable items—and the several sums required to meet the expenditure charged on the revenues of the Federation—the non-votable items—require the authentication of the Governor-General. Any question whether an item falls within the expenditure charged on the revenues of the Federation and therefore identical with or analogous to Consolidated Fund charges in the British Budget, is decided by the Governor-General in the case of the Federal Budget in his discretion. If in the opinion of the Governor-General refusal or reduction of any grant would interfere with his special responsibilities, he may include this in the schedule provided it does not exceed the amount of the rejected demand or reduction. The schedule when authenticated is laid before both Chambers but is not open to discussion or votes. Supplementary estimates of expenditure are also submitted to

the legislature and are disposed of in the same way as the items in the annual Budget. When the Budget is presented in both Houses the Finance Minister himself presents the Budget in the Lower House and steps are taken to give effect to the scheme of revenue proposed immediately after the Budget speech. The Budget is not discussed on the date of its presentation ; and when discussed resolves itself into two parts, the general discussion and the voting of supplies. The maximum number of days which can be allowed for this purpose is usually fifteen days as against twenty days in the United Kingdom, and if the discussion is not finished within the allotted period the grants are put to the vote without any discussion. The convenience of the members is taken in regard to demands which are to be put and each demand is introduced by the Minister in charge of the department and the grants are voted by major heads of expenditure. As in the British Parliament, redress of grievances precedes supplies. In India, however, there is no Appropriation Act to consolidate and legalise the supplies granted. A resolution of the legislature approving a demand for grant is considered to be a sufficient legal warrant for the appropriation. The Finance Bill, which deals with taxation or revenue, must be authenticated after passing through both Houses as in many other countries, and the work of the Federal Budget may be said then to be complete.

In the provinces the Governor must place before the Chamber or Chambers the Budget or the annual financial statement, which is constructed on lines identical with the Federal Budget. The procedure in the provinces in regard to the legalisation of the Budget differs from that of the central legislature. There is an Upper House called the Legislative Council only in six out of the eleven provinces, but these Councils have nothing to do with the voting of the demands for grants in the Budget. The Upper House is rather a body with powers of revision and delay in order to exercise a check upon hasty legislation. In those provinces where the legislature is bicameral, money bills must be initiated in and demands for grants submitted to the Legislative Assembly alone. In regard to votable expenditures the Lower House (the Legislative Assembly) has power to assent or to refuse to assent to any demand, or to assent to a demand subject to a reduction of the amount specified therein, but the Upper House has not to deal with demands for grants. Money bills cannot be introduced

in the Upper House (the Legislative Council). An authentication of the schedule of authorised expenditure by the Governor is necessary as in the case of the Governor-General in central expenditure, and this schedule when duly authenticated is laid before the Assembly, but is not open to discussion or vote in the legislature. Supplementary estimates of expenditure are laid before the Chamber or Chambers, and the procedure in regard to the passing of these is the same as in the case of items in the annual Budget.

It will be seen that the Legislative Assembly or Lower House in the case of the eleven provinces has the power of voting the Budget. The Legislative Council has not the power to assent or to refuse to assent to any demand, or to reduce any demand. It deals with legislation only such as bills increasing or decreasing court fees, land revenue, etc. Critics may urge that the grant of equal powers to both Chambers in the case of the Federation and not in the case of provinces where two Chambers exist is anomalous in spite of the fact that only six provinces have, as we have seen, a bicameral legislature. The real reason for the difference is that in the central legislature the Council of State has equal powers with the Legislative Assembly because there is need for a strong second Chamber in the legislature. The Upper Chamber represents the more conservative elements in the country, including those sections which have most to lose by hasty and ill-considered legislation. It is this necessity that has made the framers of the Government of India Act, 1935, follow the model of the Senate in the United States Constitution so far as the Budget is concerned. The Indian Legislature meets in Delhi at the end of January or early in February and continues in session ordinarily for two months. On the last day of February or thereabouts the Finance Minister presents his Budget, and the discussion of the Finance Bill takes place until well into March, when it becomes uncomfortably hot in Delhi and the Government moves to Simla. There is a session usually in August or September, lasting for several weeks, in Simla, when supplementary estimates can, as in the cold weather session, be presented. The Lower House (Legislative Assembly) receives a greater measure of notice in the Press and political circles as in America than does the Upper House (Council of State), and its atmosphere differs in financial as in other matters greatly from that of the Upper House.

(Council of State), where antagonisms are less sharp and debates far less acrimonious. There is no Appropriation Act such as exists in the British Parliament.

It has been customary to have in both Houses of the Federation and in the Legislative Assemblies in the provinces a Finance Committee representing generally the parties in the House to discuss with the Finance Minister the proposed new items in the Budget. The Finance Committee is not provided for by statute and corresponds to the Estimates Committee of the House of Commons. They scrutinise new expenditure, advise on supplementary estimates, and consider and even initiate proposals for economy and retrenchment. They have had in practice wider powers than these and have had opportunities for influencing, if not of controlling, the executive. This device of a committee has proved useful, as it reflects the legislature and can give the executive in discussion the views likely to be held when the demand for grants comes up before the House. The English system of a committee stage, a report stage, and three readings of a financial bill is almost unique and is not followed in India. In most legislatures the general rule is to refer all financial bills immediately and without preliminary discussion to a committee, either a special or an *ad hoc* committee. In India the idea that redress of grievances should precede supply is followed and takes place after the Financial Statement (or Budget Speech). Certain days are set aside for this general discussion before the detailed grants are taken up by the Assembly. The next stage is the demands for grants in the form of a series of motions. The number of days is, as we have seen, limited, and the items for debate are chosen by arrangement with Opposition leaders. This procedure is common to the central and provincial legislatures. In the former, however, there is an annual Finance Bill, as the taxes collected by the Government of India, except the tariff, are voted annually—postal rates not excepted. This arose in 1921 when a non-official member moved an amendment to the taxation bill of that year to establish a convention similar to that in the House of Commons. This was accepted by Government with the exception of the customs tariff. This goes much further than the procedure from which it is copied. In England it was customary to move the levying of one direct tax (the income tax) and one indirect tax (the tax on tea) annually to emphasise the con-

stitutional requirement for an annual meeting of Parliament and in order to have two sources of revenue readily available for annual adjustment. As there is now only one tax—the tea duty having been abolished—income-tax is the only tax requiring annual renewal. A single Finance Bill containing all the financial enactments of the year is modern. It was the plan adopted by Mr. Gladstone in 1861 when the House of Lords rejected the bill abolishing the paper duties. Annual taxes, it may be pointed out, are not required in India either to establish the right of the Legislative Assembly *vis-à-vis* the Council of State or to secure the annual meeting of the legislature. These rights are written in the Constitution of 1935 in the clearest possible manner.

In France it is interesting to note how the Estates-General failed to attain control over the purse, as it attempted to encroach upon the administrative powers of the Crown instead of confining itself to claiming the right of voting the Budget. For a period of 175 years, *i.e.* between 1614 and 1789, the Crown imposed taxation, and it regulated expenditure without the consent of the representatives of the people. In the Decree of 17th June 1789, the National Assembly promulgated the law that in future the right to vote a tax should be vested exclusively in the nation's representatives. This principle has been observed ever since, except in rare instances, as, for example, under Napoleon and in 1848, and again in 1852. Since the latter date the principle has not been broken. The control of the purse in 1789 referred to taxation, but in 1831 the right to regulate expenditure also was definitely established. Between 1789 and 1791 the civil list was separated from the public treasury.

The Minister of Finance submits the Budget to the Chamber of Deputies in the form of a law with explanatory memoranda. It is referred to the Commission of Finance, which consists of about 38 members, of whom one is Rapporteur-Général or chairman. The Commission submit their report after a few months in great detail, suggesting as a rule many changes. Hearings are held, expenditures are authorised, revenue proposals are voted, and the enactments are put into the form of a Law. The discussion is both general and clause by clause, and when each article is voted upon its annexed schedule giving details of expenditure of different Ministries is also discussed. A vote is

taken on the entire Budget. When this is complete the Budget goes to the Senate, which has its own Commission. This Commission ordinarily discusses the Budget before its formal receipt, as this saves time. It makes its report to the Senate for discussion. When the final form of the Law is agreed to between the two bodies it becomes law, and is promulgated by the President of the Republic. Many financial authorities hold that the defects of the French system are the incompetence of the members of the Commission and the multiplicity of the reports submitted. In this respect the British system is far superior.¹ The Senate's influence over budgetary matters is reduced considerably because of the power of the Chamber of Deputies in initiating the Budget, the Senate sometimes being deprived of any real opportunity to examine the Budget because of the late date on which it is sent to the Chamber. Moreover, under the Constitution the Senate can only reduce or delete items, and in this respect its power is much minimised. In practice it gets over this constitutional restriction by voting a nominal reduction in the credit, so that when the modified Budget is again submitted to the Chamber a Deputy can propose the additional amount desired by the Senate. Until 1900, Deputies could introduce amendments on their own initiative, and at the present time this power has not been entirely removed, as the legal restrictions to prevent abuse are ineffective. The unit for voting expenditure is the chapter, of which there are about 2000, and each chapter is divided into paragraphs. The paragraph is divided into services. In a few cases the article is the unit. There is no time-limit on legislative action on the Budget. If the Budget is not voted in time the Minister of Finance submits a "Projet de loi de Douzième". "Provisional Twelfths", monthly votes on account, are so frequent that they have come to be considered a normal feature of the French budgetary system. These are voted for the number of months specified and confirm existing revenue laws for the period specified. The estimates are based on the credits in the past Budget, a line for seasonal and other variable factors.

Under the Law of December 1922 on German budgetary procedure the Reichsrat, a body composed of delegates of the States,

¹ See Stourm, *The Budget*, Part II. chapter xii.; Plazinski's translation (New York: D. Appleton & Co., 1917).

examines the Budget prepared by the executive in the first place by a Commission of which the Chairman is the Minister of Finance. The Reichsrat makes recommendations, but the Minister of Finance has the power to request that the modifications be submitted to the Cabinet, which has powers to approve or reject these modifications. The Government, if it disagrees with the changes introduced by the Reichsrat, attaches its original estimates to the Budget when it is submitted to the Reichstag. In regard to these disputed items (*Doppelvorlag*) the Reichstag has to approve the Reichsrat's proposals by a two-thirds majority. If the Reichsrat inserts new items of expenditure or increases expenditures or reduces revenues or even eliminates them, it has to make suggestions to avoid any deficit in the Budget as a whole. The Budget in the Reichsrat is voted after three readings. The members of the Reichstag have the right to propose additional expenditures, but in 1931 they were prevented from increasing credits or reducing revenue without indicating the ways and means of balancing the Budget. If these proposals mean a change in the revenue side of the Budget it has to go to the Cabinet for approval. If the Reichstag increases the credits demanded by the Minister of Finance, the increase has to be submitted for the approval of the Reichsrat, and if the latter does not give a decision or refuses to assent to the increase, the President of the Reich either has to submit the Budget to a referendum of the electorate within three months or, as is more usual, orders the Reichstag to reconsider the matter. The Budget goes to the President for final authorisation. The increase is only retained if it is supported by a majority of two-thirds. Even if there is the majority the President of the Reich can decree a referendum of the people. Under Article 48 of the Weimar Constitution the President has also powers to issue the necessary ordinances if the Reichstag rejects the Budget or if it is dissolved before it can vote. The Reichstag lacks the powers of the French Chamber of Deputies and it cannot propose a new Budget. In the Reichstag the Budget is handed over after the first reading to a Budget Committee. The Budget with the changes recommended by this committee is returned to the Reichstag for a second and final reading. The Budget is normally voted at the end of March in time for the beginning of the new financial year, but if it is not voted in time provisional credits for

several months (*Nothaushaltsgesetz*) are voted. Under the emergency measures instituted on 24th March 1933 the Budget Act of 1922 is in suspension and all powers and duties are transferred to the National Socialist Government. The publication of the detailed Budget is withheld and comment on it in the press is under strict control of the Government. By the law of 1st February 1934 the sovereign rights formerly possessed by the Federal States passed into the hands of the Reich Cabinet. In Budget as in other matters, the Reich is the centralised Government and the seventeen Länder became merely administrative units. Before the Hitler régime the German legalisation of the Budget was in contrast with that of France. The German system of financial administration has been much influenced by the French system. The Reichstag, however, lacks the powers of the French Chamber of Deputies. It favoured a powerful executive *vis-à-vis* a weak legislature. The executive by the Constitution of 1922 had wide powers and by the Enabling Act of 24th March 1933 completely displaced the legislature in the legalisation of the Budget.

The Budget in the United States legislature is in refreshing contrast with that of most other countries. Before the Budget and Accounting Act of 1921 there was no proper budgetary system at all. The defects in the preparation of the Budget have been dealt with in the previous chapter. In the legislature the preparation of appropriation bills was in the hands of numerous Committees in both Houses working independently of each other, and there was no real interest in balancing receipts with expenditures. The legislature compelled the executive to spend the amount which it set aside in appropriation Acts whether Government could spend it or not. Logrolling and waste were the characteristics of this system. This has now been changed and requests for funds are considered by the Bureau of the Budget, which is under the President himself. In place of a single agency, as in the British system—the Treasury—there is also a legislative agency—the Committee on Appropriations—which retains the power to modify budgetary proposals in both Houses of the legislature. The legalisation of the Budget, therefore, is in contrast with the system obtaining in the United Kingdom, where the House of Commons cannot increase appropriations and does in practice carry out exactly what the Govern-

ment of the day demands, and where, as a result of the Parliamentary Act of 1911, the Upper House has no power to modify the Budget. The House of Lords must either accept or reject, and if it rejects, the bill becomes law. The House of Commons in the legislature has the sole right of initiative in taxation, and the House of Lords has no power to reject a money bill. As we have seen, "if a money bill, having been passed by the House of Commons, and sent up to the House of Lords at least one month before the end of the session, is not passed by the House of Lords without amendment within one month after it is sent up to that House, the bill shall, unless the House of Commons direct to the contrary, be presented to His Majesty and become an Act of Parliament on the Royal Assent being signified, notwithstanding that the House of Lords has not consented to the bill". In the United States the President with the Bureau of the Budget is now entirely responsible for the preparation of the Budget, but the legislature in theory and even in practice has equal power to change, increase, or decrease appropriations as it thinks fit. The Senate and the House of Representatives have equal powers over the legalisation of the Budget. When a difference arises, the representatives of both Houses meet together and the matter is settled in joint conference committee. Sometimes, as in the sur-tax question in 1924, when the House of Representatives was insistent on keeping a high rate of tax, the Senate agreed to the principle, and a satisfactory solution was reached by compromise. A money bill has to be a very bad bill before it fails to pass this test—compromise by both Chambers. By Section 7 of Article I. of the Constitution, bills for raising revenue originate in the House of Representatives, but the Senate can, as we have seen, propose amendments. A bill for raising revenue is one for levying taxes in the strict sense of the word, and not one which incidentally brings in money. Section 8 of Article I. provides that "the Congress shall have power to raise and support armies, but no appropriation of money to that use shall be for a longer term than two years". Section 9 of Article I. provides that "no money shall be drawn from the Treasury but in consequence of appropriations made by law, and a regular statement of all public money shall be published from time to time". This clause contains the right of authorising expenditure by the legislature. During the first seven years of the operation of the new system

introduced by the Act of 1921, the legislature showed not a single instance where Congress appropriated a larger total than that asked for by the President, and it has eliminated all the evils of legislative initiative in making estimates. In short, it retains the effective legislative consideration of the proposals of the executive. The American principle of the separation of powers requires that the final determination of the Budget must rest with the legislature. The English principle, by which the Ministry's will must prevail in the passage of the Budget through the legislature or the Ministry must resign, is not suitable to the different conditions existing in the American Republic.

The Committees in both Houses hold elaborate hearings regarding the grant of funds, and amendments are made for increasing or decreasing appropriations. In the House of Representatives the Committee on Appropriations—a strong Committee—acts on expenditures and the Committee on Ways and Means on revenue immediately after the Budget is presented. The Appropriation Committee is composed of thirty-five members in the House of Representatives and is divided into thirteen sub-committees of five members each. Each sub-committee is responsible for the framing of one of the appropriation bills, but each bill must be acted upon by the full Committee on Appropriations before it is reported to the House. All appropriation bills originate in the House of Representatives. The Committee will not consider any appropriation that has not been recommended by the Bureau of the Budget, and, if considered, it is improbable that it will be increased. Further, no official is permitted to oppose a reduction of his estimate before the Committee. Hearings are held by the sub-committees and sometimes by the full Committee, at which the Director of the Budget and other witnesses with documents, etc., may be required to be present. When the bill has been reported to the House amendments may be made. When it goes to the Senate a procedure similar to that in the House is followed, the Budget being sent to committees and sub-committees. Differences are adjusted in conference, as we have seen, after which the bills are sent to the President for approval. The Budget after approval becomes law. There is no time limit on the legislative action on the Budget. The grants are usually voted in time and there are no provisions covering the use of provisional or temporary Budgets. Deficiency

appropriation bills, however, are presented and dealt with in both Houses. The President must accept or reject an appropriation bill in its entirety. He cannot veto specific items.

INITIATION OF MONEY BILLS BY THE GOVERNMENT

3. Reference has already been made to the fact that it is now usual in many countries to restrict the power of the legislature to refuse or reduce but not to originate or increase supplies or taxation.¹ The responsibility of economising expenditure and taxation is laid on the shoulders of Ministers who are interested in making both sides of the Budget balance. This practice obtains in Great Britain, the Dominions, India, and in certain other countries. In recent years legislatures in other countries such as in France, Germany, Italy, and the United States, have by self-denying ordinances attempted to curtail the power, not without success, of members of the legislature in bringing forward demands for grants and upsetting Budget unity and Budget balance. The steps taken by the Chamber of Deputies in France, in Germany under the Act of 1922, and in Italy where the Chamber may not increase expenditures or decrease revenues unless prior sanction of the Government has been received or the recommendation has come from the Budget Committee (the Giunta Generale del Bilancio), and where the Senate has little or no power with regard to Budget as it can only approve or disapprove the Chamber's action, are illustrative of the drift of opinion in regard to money bills. The executive is more and more increasing, as it must, its power with regard to budgetary procedure, at a time when legislatures are overburdened with legislative work in all directions.

As Bagehot well puts it in his *English Constitution*: "On common subjects any member can propose anything, but not on money—the Minister only can propose to tax the people. This principle is commonly involved in mediæval metaphysics as to the prerogative of the Crown, but it is as useful in the

¹ *Vide May's Parliamentary Practice*, 12th edition, p. 477 (London, Butterworth & Co., 1917). Standing Order 66 reads: "This House will receive no petition for any sum relating to the public service, or proceed upon any motion for a grant or charge upon the public revenue, whether payable out of the consolidated fund or out of money to be provided by Parliament, unless recommended by the Crown".

nineteenth century as in the fourteenth, and rests on as sure a principle. The House of Commons—now that it is the true sovereign, and appoints the real Executive—has long ceased to be the checking, sparing, economical body it once was. It now is more apt to spend money than the Minister of the day. I have heard a very experienced financier say, ‘If you want to raise a certain cheer in the House of Commons make a general panegyric on economy ; if you want to invite a sure defeat, propose a particular saving’. The process is simple. Every expenditure of public money has some apparent public object ; those who wish to spend the money expatiate on that object ; they say, ‘What is £50,000 to this great country ? Is this a time for cheese-paring objection ? Our industry was never so productive, our resources never so immense. What is £50,000 in comparison with this great national interest ?’ The members who are for the expenditure always come down ; perhaps a constituent or a friend who will profit by the outlay, or is keen on the object, has asked them to attend ; at any rate here is a popular vote to be given, on which the newspapers—always philanthropic, and sometimes talked over—will be sure to make encomiums. The members against the expenditure rarely come down of themselves ; why should they become unpopular without reason ? The object seems decent ; many of its advocates are certainly sincere ; a hostile vote will make enemies, and be censured by the journals. If there were not some check, the ‘people’s house’ would soon outrun the people’s money. That check is the responsibility of the Cabinet for the national finance. If any one could propose a tax, they might let the House spend it as it would, and wash their hands of the matter ; but now, for whatever expenditure is sanctioned—even when it is sanctioned against the Ministry’s wish—the Ministry must find the money. Accordingly, they have the strongest motive to oppose extra outlay. They will have to pay the bill for it ; they will have to impose taxation, which is always disagreeable, or suggest loans, which, under ordinary circumstances, are shameful. The Ministry is (so to speak) the bread-winner of the political family, and has to meet the cost of philanthropy and glory, just as the head of a family has to pay for the charities of his wife and the toilette of his daughters. In truth, when a Cabinet is made the sole executive, it follows

it must have the sole financial charge; for all action costs money, all policy depends on money, and it is in adjusting the relative goodness of action and policies that the executive is employed.”¹ In India, neither in the central nor local legislatures can expenditure or taxation take place except on the recommendation of the Executive Governments.² The President of the Council of State in India referred to this as follows: “I think it will be quite clear to the Honourable Members if they refer to Section 67 A (2) of the Government of India Act (1919), that the framers of that Act have therein given statutory expression to the English constitutional rule that demands for supply must proceed from the Crown; in other words, the legislature can reduce, but it cannot increase expenditure. That is quite clearly expressed in the Act. If that is so, it seems to me to involve the necessary consequence that taxation, to provide for such expenditure, must also be initiated by the Crown. Indeed, Section 67 of the same Act could be construed in the same way. I think I must therefore rule that an amendment, except by a member speaking on behalf of Government, which has the effect of increasing taxation proposed by the Bill is out of order, unless it proposes taxation by way of equivalent to a tax brought by the Bill under the consideration of the Council. The point is this, that the Crown makes a demand, the Crown proposes taxation, the Council can reduce the demand or the taxation, but it can neither increase the demand nor can it increase the taxation, except at the instance of a member of the Government. But it is open to members who desire to vary what I may call the incidence of taxation imposed by the provisions of the Bill, to propose an increase in one item compensated by a corresponding reduction in some other item.”³

The President of the Legislative Assembly similarly gave the following ruling: “I think it is obvious that the Imperial Parliament intended to confer the same powers and the same restrictions regarding the levy and appropriation of public revenues which it itself enjoys. Neither the House of Commons nor the Legislative Assembly is empowered to increase a demand

¹ *The Works and Life of Walter Bagehot*, vol. v. pp. 255-6, Mrs. Russell Barrington (Longmans, 1915).

² Government of India Act, 1935, clauses 37 and 82.

³ *Council of State Debates*, p. 526, 21st March 1921.

for a grant. The House of Commons is equally forbidden to increase a tax. That general principle has been laid down many times, and I think that it is one which we ought to apply here. Therefore, those amendments which propose increases of taxation will not be in order.”¹

In the Bombay Legislative Council the President referred to the words of the Speaker in the British House of Commons, in 1908, when he said, “In a committee we cannot go any further than the authority given on the recommendation of the Crown. It is one of the protections of the taxpayer. If the Chancellor of the Exchequer tells me and the House that the scheme proposed is a charge on public revenues, I am bound to accept that statement.”²

ANNUAL VOTING OF THE WHOLE BUDGET

4. Certain heads of revenue and expenditure are not voted every year. There is a classic instance in the case of Germany where the military Budget before the War was voted for seven years, and it was therefore not a matter for the annual debate.

In France the great Mirabeau argued in favour of making no tax votable for more than a year except the one devoted to the service of the debt and the civil list. It was not carried, but in the Constitution of 1791 it was clearly laid down that funds set apart for debt or the payment of the Civil List could not be refused or suspended. In 1827 the matter was again considered with a view to dividing the Budget into two parts ; the Budget of the Consolidating Fund and the extraordinary Budget. Into the former were to be placed all permanent and fixed services, and new charges of an accidental or temporary nature were to be included in the latter. It was proposed to make the former charges, *i.e.* those against Consolidated Fund, permanent in order to save the time of the Chambers, which might be devoted to the examination of new expenses, but this was not adopted, with the result that at the present time a plethora of detail is given.³ It is interesting in this connection to remember that in the First Republic and under the

¹ *Legislative Assembly Debates*, p. 3719, 19th March 1923.

² *Parliamentary Debates*, vol. 191, col. 1512.

³ Stourm, *The Budget*, Plazinski's translation, p. 323.

First Empire appropriations were voted *en bloc* and by Ministries, during the first part of the restoration and the first part of the Second Empire by Grand sections, at the end of the restoration and once during the Second Empire and by chapters in 1830, in 1853, and since 1869. In regard to the detail in which the Budget should be voted it was necessary to see not only that balance in appropriations between offices and offices or departments and departments in the public services should be preserved, but care must be taken to see that sufficient legislative control prevails. Otherwise the executive may be wasteful in expenditure. Each vote should have a definite and precise meaning or aim, and the compromise between conflicting interests must be followed. The broad services may be divided, as in the civil estimates or book of estimates, into broad heads and chapters or major heads, and those which are votable annually should be separated from those which are voted permanently. In England Parliament provided for the establishment of a Consolidated Fund in 1787. The proceeds of taxation and other sums of money received by the Treasury on behalf of the Crown are carried to the Consolidated Fund. Permanent charges for the service of the State are secured by Statute upon that Fund, which the Treasury is bound to defray according to law. At present the items included under the Consolidated Fund service are the National Debt service, payments to local taxation accounts, the civil list, annuities and pensions, salaries and allowances, courts of justice and payments to the Northern Irish Exchequer, land settlement, the road fund, and certain other miscellaneous expenditure. This formed in 1934-35 £261 millions out of a total expenditure of £797 millions chargeable against revenue, or 33 per cent.¹

In India the non-votable items under the Government of India Act, 1935, are in the nature of permanent appropriations. The distinction between votable and non-votable expenditure has given rise to interesting rulings. The Hon. Sir Narayan Chandavarkar, the first President of the Legislative Council, ruled that where the head of a Department's salary was non-votable, it was not possible to cut down the votable salaries of officers, such as clerks, etc., on the ground that the head of that

¹ The average for the decennial period 1925-26 to 1934-35 is 46 per cent. The service of the public debt was greatly reduced (*vide Chapter XXXV.*) in 1933-34.

Department is unnecessary or unfit or such like reason pertaining to him personally or his office or position. He cited certain rulings in the House of Commons in support. "Where a demand for the establishment of the Lord Chancellor was made in the House of Commons, a reduction was moved in the expenses of that establishment on the ground of the position of the Lord Chancellor, but the Chair ruled: 'It is out of order to do indirectly what can't be done directly. The position of the Lord Chancellor can't be discussed on this vote' (*P.D. H. of C.* 4th Ser. vol. 17, col. 163). So also, when a demand was made for the salaries of the clerks of the House of Lords, reduction was moved on the ground that the House of Lords was obstructive and therefore unnecessary. The Chancellor of the Exchequer, on a point of order, protested that to reduce the salaries of the clerks for the purpose of attacking their master, the House of Lords, was like carrying on war by killing the baggage-bearers. 'A strange thing if we began contest with a great man by cutting down the salaries of his servants.' Upon that the Chair ruled: 'Nothing is really open to discussion on this vote except the duties and salaries of the clerks. I don't think the policy of the House of Lords is open to discussion on this vote. The Committee can discuss only the duties and remunerations of the officials' (*P.D. H. of C.* 4th Ser. vol. 28, cols. 1426 to 1428). Again, on demand made for repayment to the Civil Contingencies Fund of certain miscellaneous advances, Mr. Lloyd George moved a reduction on the ground of a principle, namely, that the Lord Lieutenant of Ireland's office was a sinecure, but the Chair ruled: 'The salary of the Lord Lieutenant is placed upon the Consolidated Fund' (*i.e.* it is non-votable) 'in order that he may not be criticised in this style. The only question into which the honourable gentleman can enter is that of the adequacy of this expenditure' (*Hansard*, 3rd Ser. vol. 348, col. 905)."¹

The advantages of not discussing the entire Budget annually are that time will be economised and greater justice done to the remaining items. Moreover, when interest on loans is not subjected to an annual vote greater confidence is produced, as credit and stability count for much. On the other hand, expenditure on supply services including new items of expenditure should come under the annual purview of the legislature.

¹ *Bombay Legislative Council Debates*, 9th March 1923, p. 935.

THE POWERS OF THE TWO CHAMBERS

5. The relative powers of the two Chambers have frequently been discussed. A scrutiny of the detailed heads twice over is considered a waste of time by some authorities who want to restrict the powers of the Upper Chamber to a discussion of general principles only. In the British Parliament the lower House only can initiate Money Bills. The House of Commons only can grant supplies. It is paramount and has the privilege of initiative in taxation. It is for the House of Lords to assent. Money Bills cannot be amended by the Lords on their way to receive royal assent. The supremacy of the House of Commons in money matters can be seen from the Speech of the Throne. The King begins with "My Lords and Gentlemen", but referring to finance he says, "Gentlemen of the House of Commons, I have given orders that a statement of the funds necessary for the operations of the year be submitted to you". While reverting to foreign affairs he again refers to "My Lords and Gentlemen". A classic instance of this is seen in 1407, when Henry IV. initiated financial discussion in the House of Lords. The Commons objected to this procedure, and the King recognised the principle that the money grants were made by the Commons and assented to by the Lords.¹ They were not to be reported to the King until both Houses were agreed and were to be reported by the Speaker of the Lower House. Thus well over five centuries ago a long step had been taken to assert exclusive control over taxation which was asserted in later times with success. In 1625 it was resolved that the rate or tax should not be altered by the House of Lords. In 1678 it was decided that all supplies ought to begin with them. "All aids and supplies and aids to His Majesty in Parliament are the sole gifts of the Commons, and all bills for the granting of any such aids and supplies ought to begin with the Commons, and that it is the undoubted and sole right of the Commons to direct, limit, and appoint in such bills the ends, purposes, considerations, conditions, limitations, and qualifications of such grants, which ought not to be changed or altered by the Lords." There was no real conflict from this time until 1860. When the Paper Duty Repeal Bill was rejected by the House of

¹ Anson, *Law and Custom of the Constitution*, vol. i. p. 269 (Oxford Clarendon Press, 1909).

Lords in that year the House of Commons passed the following resolutions :

“ That the right of granting aids and supplies to the Crown is in the Commons alone as an essential part of their Constitution ; and the limitation of all such grants as to matter, manner, measure, and time is only in them.

“ That although the Lords have exercised the power of rejecting Bills of several descriptions relating to Taxation by negativing the whole, yet the exercise of that power by them has not been frequent and is justly regarded by this House with peculiar jealousy, as affecting the right of the Commons to grant the supplies, and to provide the ways and means for the service of the year.

“ That to guard, for the future, against an undue exercise of that power by the Lords, and to secure to the Commons their rightful control over taxation and supply, this House has in its own hands the power so to impose and remit taxes, and to frame Bills of supply, that the right of the Commons as to the matter, manner, measure, and time may be maintained inviolate.”¹ In 1909 the Finance Bill was not assented to by the House of Lords on the ground that the judgment of the country was necessary. Parliament dissolved, and the country supported the Government measure. The new Parliament passed the Bill, and an Act—the Parliamentary Act of 1911²—became law which provided that a Money Bill passed by the House of Commons and sent up to the House of Lords one month before the end of the session is, if the House of Lords does not pass the Bill without amendment within one month after the Bill is sent to it, to be presented to His Majesty and to become an Act of Parliament. By this Act the House of Lords cannot reject a Money Bill. The Act requires on every such bill when it is sent to the House of Lords and when it is presented to His Majesty for assent a certificate from the Speaker that it is a Money Bill. The Speaker consults, if possible, before giving his certificate, two members from the Chairmen’s panel appointed at the beginning of each session by the Committee of Selection. It is also provided that “ Nothing in this Act shall diminish or qualify the existing rights

¹ 115 C, J, 360; 159 H, D, 3, § 1383; cf. p. 517, May’s *Parliamentary Practice*, 12th edition.

² 1 & 2 Geo. V. c. 13; cf. p. 397, May’s *Parliamentary Practice*, 12th edition.

or privileges of the House of Commons". The Lower Chamber has the right of initiative in taxation which is recognised by the Upper Chamber. If the Upper Chamber introduces a bill which imposes a charge on revenues when it is read a third time the financial clauses are omitted, but when sent to the Lower House are printed in special type in the bill. The House of Commons reinserts the financial clauses. Alternatively the financial clauses are left in the bill followed by a clause negativing this charge, the House of Commons then omits the formal negative and the bill is passed. This is merely a device in order to avoid a clash on account of the House of Commons' privileges.

In Canada all Money Bills must originate in the Commons. The Senate may reject these Bills, but cannot amend them. The power of rejection is seldom used. The Australian Constitution forbids the Senate to originate or to amend Money Bills. In the United States the Senate may alter a Money Bill. The Finance Committee of the Senate is a dominating power on the Congress, and full of initiative. It commences working on the Budget about the time when the House of Representatives takes it into consideration.

In Article 8 of the French Constitutional Law of 28th February 1875, it is laid down that "the initiative and the making of laws rests jointly with the Senate and the Chamber. The fiscal laws, however, must be submitted first to the Chamber of Deputies and voted by the latter."¹ The last four words, "voted by the latter", have given rise to much controversy. The Senate argues that these words were inserted merely to prevent the withdrawal of the Budget by the Executive from the supplies immediately after submission. The Deputies argue that the first and the last word on the Budget should rest with them. The issue has not been settled by any constitutional convention, and pressure is brought to bear upon the Senate by submitting the Budget at a late date, and the Senate yields with almost praiseworthy abnegation. Such disputes in France are usually settled by mutual concessions under pressure of time after two or three conferences.

REAPPROPRIATIONS AND RESERVE FUNDS

6. The question of reappropriations is an important one, as power to reappropriate involves in most cases the sanction of the

¹ Stourm, *The Budget*, Plazinski's translation, pp. 312-13.

legislature. In modern constitutions Governments are given powers of reappropriation or "*virement*" usually under rules or within limits. Thus under the Indian Constitution it is laid down that, after grants have been voted by the Legislative Assembly, the Finance Department can sanction reappropriation within a grant from one major, minor, or subordinate head to another. In the Report of the Public Accounts Committee based on the Appropriation Report of the Accountant-General every reappropriation from one grant to another, and every reappropriation *within* a grant not conforming to the rules of the Finance Department, should be brought to the notice of the legislature. In some countries "token grants", *i.e.* demands for nominal sums, the total expense being met by reappropriation, are applied for merely to bring the matter to the notice of the legislature. It is customary to leave the Executive with certain funds to be used as a reserve and to be accounted for in the next financial period or Budget. Thus in Great Britain there are the Treasury Chest and "Civil Contingencies", and in most Governments a reserve is necessary. The Civil Contingencies Fund is a loan fund of £1,500,000 which the Treasury controls and out of which it can make temporary advances to the Civil departments. These advances are for expenditure in regard to an established service which has urgently to be undertaken before a grant by Parliament is possible. No provision has been made in the estimates, and payment cannot be postponed until the next financial year. Advances are also necessary in the case of the small over-spending of grants which the Treasury may hold to be inevitable. These two types of advances are repaid to the Fund out of grants of Parliament made for special purposes under supplementary estimates or excess grants. The capital of the Fund is restored and maintained intact from year to year. At the end of the financial year it is outstanding in the hands of the Paymaster-General in the form of a balance, and this sum is carried forward into the next financial year to the account of the Fund. On account of the wide powers of *virement* granted to the fighting services, no special machinery of this sort is required for these. The Fund is annually audited by the Auditor-General and the results are presented to Parliament through the Public Accounts Committee, which watches that the Fund is not made use of to defeat the limitations of appropriation, *i.e.* to avoid unspent

balances from being surrendered on the 31st March each year, the doctrine of lapse¹ which has been the rule in British finance since 1866.

The Treasury Chest Fund is a fund by means of which the Treasury carries on the business of exchange for various departments which have to meet expenditure overseas such as the payment for regiments, for the navy, and for the diplomatic service abroad. As rates of exchange vary, and as it is not possible to estimate accurately the cost of transferring these funds abroad, provision is made not in the departmental budgets but in this Treasury Chest Fund. Its advantages are that it prevents the departments themselves from losing part of their grants in transferring them abroad and in having a part of their amount locked up in the course of transfer. The Treasury, in short, acts as an exchange banker for the departments. It makes good the losses on exchange, not always entirely, as part of this is provided for in the votes, such as these of the navy estimates. It is not to be confused with the Civil Contingencies Fund, as the Chest Fund is used always abroad and can be made only in regard to sums already granted by Parliament and at the same time available for repayment to the fund. Advances from the Civil Contingencies Fund, however, are made on the credit of money actually available but not yet sanctioned by Parliament. In two respects they are similar. In the first place the repayments have to be made before the end of the year to both funds, so that their capitals are maintained intact from year to year. Secondly, both funds are audited by the Auditor-General, and the report of this audit is submitted to the Public Accounts Committee. The system of empowering the Executive to extend grants from this reserve for approved services does not always commend itself to jealous advocates of the powers of the legislature. It should, however, be remembered that this reserve is usually small, and it is essential to have such a sum for unexpected events when the legislature is not in session.

¹ The British Exchequer and Audit Departments Act of 1866 is elastic enough to permit in rare cases unspent balances to be carried forward to the next year. The necessary explanation is given in the next appropriation account, but this is most rare. The Ordnance factories vote is one example. (See Public Accounts Committee, Second Report, 1896.) On one occasion the National Health Insurance Commission vote was allowed to suspend surrender. (See Appropriation Accounts for 1913-14.) Cf. Hawtrey, *The Exchequer and the Control of Expenditure* (Oxford University Press, 1921), p. 55.

THE VETO AND THE RESTORATION OF DEMANDS
FOR GRANTS

7. It is sometimes thought that the heads of Constitutions, as in the self-governing Dominions and other States, perform duties which could quite well be done by the use of a rubber-stamp. This, however, loses sight of the manner in which financial policy may be modified by the advice given to members of the Executive responsible or by the action taken by the head of the Government himself. He may veto a legislative enactment. The veto, for example, was exercised in Canada in 1873 by the Governor-General in regard to the Oaths Bill. This was disallowed as being *ultra vires* of the Parliament of Canada. The Governor-General of Australia similarly withheld his consent to a proposed Act, and referred it to Downing Street. This was in connection with the Australian Navigation Act, 1912. The Act was finally approved, but the delay gave time for reflection regarding the results of the law, so that it has not been put into force in its entirety. In the Indian Constitution the Governor-General and Governors¹ of provinces possess the power of vetoing legislation, including, of course, finance legislation. In the United States, under Section 7, Article 1, of the Constitution, "every Bill which shall have passed the House of Representatives and the Senate shall, before it become a law, be presented to the President of the United States. If he approve he shall sign it, but if not he shall return it, with his objections to that House in which it shall have originated, who shall enter the objections at large on their Journal, and proceed to reconsider it. If after such reconsideration two-thirds of that House shall agree to pass the Bill, it shall be sent, together with the objections, to the other House, by which it shall likewise be reconsidered, and if approved by two-thirds of that House, it shall become a law." If any Bill is not returned by the President within ten days after its presentation to him, it becomes a law. If it is returned within ten days, unless this Bill is passed by both Houses by two-thirds majority, it does not become law. Thus the Soldiers' Bonus Bill of 1924 was re-passed over President Coolidge's veto by an overwhelming majority. In the case of the Immigration Bill the President did not apply a veto, which would obviously have proved ineffective. Presidents

¹ Sections 32 and 75-77 of the Government of India Act, 1935.

Jackson, Tyler, Johnson, and Cleveland employed this veto power. President Cleveland vetoed no less than 413 Bills during the first term of his office, more than two-thirds of which were private pension Bills. The most important Bill vetoed was the Dependent Pension Bill—a measure so vague that it might have led to enormous frauds upon the Treasury. Presidents Adams, Jefferson, John Quincy Adams, Van Buren, William Henry Harrison, Fillmore, and Garfield never vetoed a Bill passed by Congress. Generally, the other Presidents vetoed but few. Washington vetoed 2, Madison 6, Monroe 1, Jackson 9, Tyler 8, Polk 3, Pierce 9, Buchanan 7, Lincoln 3, Johnson 22, Hayes 8, Arthur 4, Benjamin Harrison 19, Cleveland (second term) 42, McKinley 6, Roosevelt 40, Taft 26, and Wilson 26. Bryce says that the American people admire their President because he has an opinion of his own and is not afraid to enforce it. In all the States of the Union, except one (North Carolina), Bills passed by the two Houses must be submitted to the State Governor for his approval. Should the Bill be returned to the legislature disapproved, it is lost unless re-passed over his veto by a majority of two-thirds, but sometimes larger, in each House. A good governor uses his veto freely, as this is considered in many States to be a test of a governor's judgment and courage. The power of the veto is a negative one. *Veto* (I forbid) was, of course, the expression used by the tribune of the people in nullifying measures under the Roman Republic.

It is sometimes necessary to certify, restore, or authorise. Thus expenditure may be certified, restored, or authorised as a positive Act of the Executive. The House of Commons in 1871 refused to abolish the purchase of commissions in the Army, and this was carried through by Royal Warrant, an Executive Act.¹ Failure to vote the Budget is the counterpart of the right to authorise the Budget, and rarely have legislatures taken this extreme measure. Failure to vote the Budget is always regarded as a sign or even the result of political unrest. King Charles I. held that if the legislature refused to approve the levying of taxes, and thus failed in their duties, the King may act upon his authority by virtue of the divine right of kings. In the famous struggle between Pitt and Fox towards the end of the eighteenth

¹ This is published in Appendix I. p. 483, vol. ii., Anson, *Law and Custom of the Constitution* (Oxford University Press, 2nd edition).

century, Fox managed to secure the adjournment of the vote on subsidies on five or six occasions. "It cannot", he said, "be contested that the Constitution gives to the House the right to refuse the funds; but this is a weapon which the House must use with caution, and only when the public cause imperatively demands such action. I shall always uphold this right." Erskine May rightly says that this weapon is now rusting in the arsenals of constitutional laws. In Prussia, Bismarck carried on the Government for four years (1862-66) without the grant of supplies from the Landtag, but with the support of the Upper House. The funds were required for military reorganisation. When Prussia defeated Austria at Sadowa the effects of Bismarck's policy were clearly demonstrated. Later King William admitted that the Budgets of the years 1862-66 had not conformed with the law.¹ In France in 1877 the Budget was not voted till the 15th December, i.e. until a new Cabinet from the ranks of the majority of the Chamber of Deputies was appointed. In the Indian Constitution it is provided that when expenditure is refused grants may be *restored*. The Governor-General and a Governor have this power under the Government of India Act, 1935, where the refusal or reduction would affect the due discharge of any of the special responsibilities of the Governor-General or of a Governor of a province. It will be seen that for the head of the Executive in India both in the federation and in the provinces, certain financial safeguards have been inserted into the Constitution. The Joint Committee of both Houses of Parliament commenting on their nature and objects in the new Constitution said that "The safeguards we contemplate have nothing in common with those mere paper declarations which have been sometimes inserted in constitutional documents, and are dependent for their validity on the goodwill or the timidity of those to whom the real substance of power has been transferred. They represent on the contrary (to quote a very imperfect but significant analogy) a retention of power as substantial, and as fully endorsed by the law, as that vested by the Constitution of the United States in the President as Commander-in-Chief of the Army—but more extensive both in respect of their scope and in respect of the circumstances in which they can be brought into play. On the

¹ Stourm, *The Budget*, Plazinski's translation, p. 22 (London: Appleton, 1917).

other hand, they are not only not inconsistent with some form of responsible government, but in the present circumstances of India it is no paradox to say that they are the necessary complement to any form of it, without which it could have little or no hope of success."

Safeguards are not confined to the world of finance but exist for many other purposes in Constitutions. They are too common in various walks of life, like the safeguards for a motorist on the road to prevent accidents which could be fatal. The motorist, on seeing a safeguard notice, slows down in passing school or cross-roads. A safeguard is there for a definite purpose. Such safeguards are used by the motorist as and when required ; they prevent catastrophes. Safeguards are sometimes regarded as interfering with self-government, but in reality this is not the case. Full provision must be made for the maintenance and efficiency of the fundamentals of a Government, especially in the sphere of finance, as a nation's credit is a delicate piece of furniture which cannot be dusted with a Turk's-head mop. However much the doctrine that good government is no substitute for self-government may be subscribed to, care must always be taken not to permit all Governments being replaced by anarchy for this purpose. Safeguards are, therefore, necessary.

CHAPTER XL

THE EXECUTION OF THE BUDGET

INTRODUCTION

1. AFTER the legalisation or vote of the Budget adequate machinery is required to secure conformity with the views of the executive and the legislature on it. Unless this exists and works with efficiency, the preparation and the vote of the Budget will be rendered nugatory. This branch of the subject is known as the execution of the Budget, and includes the collection of the revenue, the custody of public moneys, the methods of spending in accordance with appropriations and the services performed by the Treasury or Finance Ministry in the country concerned. The topics of control and audit are the most important of this branch of financial administration. Control is used in two senses, sometimes in the technical sense of the control of issues from the Treasury and sometimes in a wider sense to embrace all forms of control, judicial, legislative, and administrative, over expenditure, receipts, and loans. Thus control in the latter sense would include (1) the administrative control exercised by the head of a department and by the Treasury or Finance Department over other offices, (2) the judicial control exercised, for example, by the Court of Accounts in France, and also (3) the legislative control exercised through the Committee of Public Accounts. By "audit" is meant the verification and examination of accounts before the expenditure takes place (pre-audit) or after the expenditure has been incurred (post-audit). Audit is essential to secure that the funds are not in any way spent improperly and at the same time spent exactly in conformity with the will of the legislature. Audit originally consisted of the hearing of explanations from those rendering the account. "Look into your affairs often, and cause them to be reviewed, for those who serve you will

thereby avoid the more to do wrong, and will take pains to do better. In the first place he who renders accounts ought to swear that he will render a lawful account and faithfully account for what he has received of the goods of his lord, and that he will put nothing in this roll save what he has to his knowledge spent lawfully, and to his lord's profit. . . . The lord of the manor ought to command and ordain that the accounts be heard every year, not in one place, but on all the manors, for so can one quickly know everything and understand the profit and loss.”¹ In recent years audit has assumed great importance in financial administration and in Constitutions and in Acts of the legislature the head official in charge of audit is given large and independent powers. Audit is not a mere formal examination of authorities and of rules. It does not merely see whether there is quoted authority for expenditure but it investigates also the necessity for it. The *raison d'être* of audit, as the Government of India in its Despatch on the Reforms of 1919 well described it, is briefly that “it will ask whether individual items were in furtherance of the scheme for which the budget provided ; whether the same results could have been obtained otherwise with greater economy ; whether the rate and scale of expenditure were justified in the circumstances ; in fact, they will ask every question that might be expected from an intelligent taxpayer bent on getting the best value for his money. The Audit Officers will also devote more of their time to looking into the manner in which various executive officers are undertaking their more important financial responsibilities.”

From time to time changes to meet changed circumstances are necessary in the execution of the Budget. The machinery must be brought up to date in spite of the opposition to change the working of a system on the part of the official hierarchy. It was with this end in view that Burke in his great speech of 1780 put forward “a plan for the better security of the independence of Parliament and the economical reformation of the civil and other establishments”. He laid stress on the importance of the execution of the Budget and suggested doing away with the sinecures

¹ From the very remarkable book by Walter de Henley, *Tretice of Husbandry* (*circa* 1200–1250), Cambridge University Library. Several other manuscripts of this popular work still survive, for example, at the Guildhall and the British Museum, London, the Bodleian, Oxford, and the Bib. Nat. Paris. Cf. translation by Lamond with introduction by W. Cunningham, 1890.

in regard to this part of financial administration. The audit of the two Auditors of Imprest was found to be nothing short of a scandal and each auditor was found to be in receipt of £16,000 a year. He was paid by fees and did his work by a deputy.¹ £75,863 were in 1780 distributed among the high officials and their staffs. Of this sum the auditor received for himself £10,816, the Clerk of the Pells £7597, the four Tellers £27,930, the four "second clerks" of the Tellers (also sinecurists) £4193, and the Usher £4200. The Auditor, the Clerk of the Pells, the four Tellers, and the Usher owed their appointments to the fact that their fathers held high offices in the State at the time when the vacancies arose which they filled. The Auditor, for example, was nephew and successor of a Prime Minister, the Clerk of the Pells and the Usher were brothers and sons of a Prime Minister, and of the four Tellers one was the son of a Prime Minister and the other three were sons of Lord Chancellors. No wonder that Burke said, "My idea therefore is to reduce these offices to fixed salaries, as the present lives and reversions shall successively fall. It will not be difficult to calculate the value of this fall of lives to the public, when we shall have obtained a just account of the present income of these places; and we shall obtain that account with great facility if the present possessors are not alarmed with any apprehension of danger to their freehold office", and he wound up his speech by moving for leave to bring in a bill "for the better regulation of His Majesty's civil establishment and of certain public offices; for the limitation of pensions and the suppression of sundry useless, expensive, and inconvenient places, and for applying the moneys saved thereby to the public service". These auditors were abolished in 1785² by statute, and a body of five commissioners was appointed for auditing the public accounts. This body, known as the Audit Board, was abolished when its duties were transferred to the Comptroller and Auditor-General by the Exchequer and Audit Act of 1866, on which the present system of control of issue and audit rests even after the passing of the Amending Act of 1921. A result of Burke's speech in 1780 was the appointment of a Commission, in the same year, of six persons to examine the public accounts of the kingdom,

¹ *Report on Public Income and Expenditure*, 1869; Part II., Appendix No. 13, p. 331. Cf. Anson, part ii. p. 331.

² 25 Geo. III. c. 52.

and this Commission presented at intervals fifteen detailed reports, the last in December 1786, to the House of Commons. This Commission was less concerned with the particular methods of conducting business in the Exchequer than with repressing the numerous sinecures with their enormous fees. The Exchequer officials were, like many of their successors at the present day, conservative to a degree. The Act of 1697 entitled "an Act for the better observation of the course anciently used in the Receipt of Exchequer",¹ was quoted by Exchequer officials as crystal-lising and making sacrosanct their procedure. The procedure itself, as we shall see, was in need of re-examination and of modernisation. Parnell in his pamphlet *Financial Reform*² criticised the methods by which the public expenditure was managed and the large balances which lay, for example, with the Treasurer of the Ordnance. The Paymasters could use the large balances that were with them. We have, for example, the case of C. J. Fox's paternal grandfather, Sir Stephen Fox, and his own father, Henry Fox, who made large fortunes in the office of the Paymaster. Sir Stephen Fox's friend Evelyn computed him to be worth in 1680 at least £200,000 "honestly got and unenvied, which is next to a miracle". Pepys in his *Diary* narrates that Sir Stephen Fox was enabled to make large profits from the office. Henry Fox, his son, was reported to have made millions. In 1769 the Lord Mayor presented a petition to the King from the livery of the city of London against his ministers in which Fox was called "the public defaulter of unaccounted millions". Proceedings had actually been commenced in the Court of the Exchequer but had been stayed by a warrant from the Crown. It was a Commission appointed under the Royal Warrant of King William IV. of 8th July 1831 to inquire "Into the manner in which the public money is received and paid" that succeeded in securing the final abolition of the old Exchequer system. In its report³ the Commission pointed out that all the forms and practices in force could be traced back to very remote periods

¹ 8 and 9 William III. c. 28.

² Published in 1830, ch. xi. p. 136 on "The Management of the Public Expenditure". Cf. p. 181: "The Treasurer of the Ordnance has a power over the public money, which ought not to be vested in any public officer. If, for instance, he wishes to have the use of money for a few days, he may draw a cheque for any sum he pleases."

³ Parliamentary Paper No. 313 of 1831.

and that, notwithstanding the changes and improvements which experience and civilisation had introduced into monetary transactions, the forms of the Exchequer underwent little or no alteration. The Commission recommended the complete abolition of the old system and the sweeping away of the offices of the Auditor, the Clerk of the Pells, and the Tellers and the substitution of a Comptroller-General of the Exchequer on a salary of £2000 a year, which was raised to £3000 in March 1920,¹ with a staff of eight subordinates costing £2600 a year in place of sixty-eight officials of the old department costing to Government £44,489 per annum. The Bank of England took over the receipts and issues of the Exchequer with effect from 11th October 1834 and all "books, records, deeds, papers, documents, and vouchers whatsoever relating to the office of the receipt of the Exchequer" were made over to the new Comptroller-General. The old Exchequer died on 10th October 1834 when the officers met for the last time and had their last quarter-day's dinner. On the morning of the 11th the new establishment met in the old building in New Palace Yard, many of the rooms being unoccupied. The large and lofty room on the first floor, facing the Thames and known as the Star Chamber, was filled with old tally sticks. These were destroyed by using them for fuel in the Houses of Parliament, as the Star Chamber was now to be used as a Committee room for Parliamentary business. Charles Dickens describes the burning of the Houses of Parliament as a result of this, five days after the ancient Exchequer had ceased to exist : "The stove, overgorged with these preposterous sticks, set fire to the panelling ; the panelling set fire to the House of Lords ; the House of Lords set fire to the House of Commons ; and the two Houses were reduced to ashes".² In 1921 the Exchequer and Audit Department Acts of 1866 and 1889 were amended by the Exchequer and Audit Department Act of that year which provided, *inter alia*, that stores and revenue accounts should also be audited by the Auditor-General and reported on to the Public Accounts Com-

¹ In August 1921 Government introduced legislation to legalise this, as it was admittedly irregular and illegal. The House of Commons at the time took strong exception to the procedure but sanctioned additional expenditure only after the Government admitted its error and to avoid punishing a public servant who had rendered distinguished service to the State.

² Charles Dickens's speech on Administrative Reform delivered at Drury Lane Theatre on 27th June 1855.

mittee of the House of Commons. This Committee, which dates back to 1861 when Gladstone was Chancellor of the Exchequer, is formed annually in January or February at the beginning of the Parliamentary session, and is assisted by the Comptroller and Auditor-General and one official of the Treasury in the auditing of the accounts of the year and in drawing up the report to Parliament. To this we shall again refer, but it may be said, generally speaking, that Great Britain, possessing as it does the oldest system of accounts and the oldest system of Exchequer procedure, improved its system, but only after the time for change had long been passed. After the Great War this improvement was carried out especially in regard to the effective carrying out of the Budget.

The United States, by an Act of Congress passed in 1921,¹ created a General Accounting Office "which shall be independent of the Executive departments and under the control and direction of the Comptroller-General of the United States". This took the place of the Offices of the Controller of the Treasury and Assistant Controller of the Treasury. It was also provided that "there shall be in the General Accounting Office a Comptroller-General of the United States, who shall be appointed by the President with the advice and consent of the Senate".² This Act clearly shows the importance of this branch of the administration, as it lays down the scope of the Comptroller-General's work thus: "(a) The Comptroller-General shall investigate, at the seat of Government or elsewhere, all matters relating to the receipt, disbursement, and application of public funds, and shall make to the President when requested by him, and to Congress at the beginning of each regular session, a report in writing of the work of the General Accounting Office, containing recommendations concerning the legislation he may deem necessary to facilitate the prompt and accurate rendition and settlement of accounts, and concerning such other matters relating to the receipt, disbursement, and application of public funds as he may think advisable. In such regular report, or in special reports at any time when Congress is in session, he shall make recommendations, looking to greater economy or efficiency in public expendi-

¹ Budget and Accounting Act, 1921; Barnes U.S. Statutes Cumulative Supplement, 1923, p. 18.

² Act 10th June 1921, C. 18, §§ 301 and 302, 42 Stat. 20.

tures."¹ It is also provided that "all departments and establishments shall furnish to the Comptroller-General such information regarding the powers, duties, activities, organisation, financial transactions, and methods of business of their respective offices as he may from time to time require of them ; and the Comptroller-General, or any of his assistants or employees, when duly authorised by him, shall, for the purpose of securing such information, have access to and the right to examine any books, documents, papers, or records of any such department or establishment".²

The General Accounting Office, therefore, can demand information from any office ; it can demand on the spot any document and ledger ; and on the request of the Government departments or the Paymasters it can interpret the law concerning the Budget and decide whether a certain credit may be employed for a certain purpose or not. Congress alone can change its rulings. Congress and their Committees, as well as the Bureau of the Budget, frequently require the Office to investigate questions and to report. The functions of the Comptroller-General in the United States may be compared with those of the Comptroller and Auditor-General in Great Britain. Since 1921 the efficiency of control and audit has been greatly increased and uniformity in accounting has been introduced with advantage.

Most other governments have taken steps to emphasise the importance of control and audit. In Germany, for example, there is the autonomous Rechnungshof which is charged with the proper execution of the Budget. This autonomous body sees that the law in regard to the Budget and to financial procedure has been kept and whether any excess or unnecessary expenditures have been incurred. In France there is no authority comparable to the office of Comptroller and Auditor-General in Great Britain to prevent even the Minister of Finance from violating the wishes of Parliament. There are, however, Contrôleurs of expenditures and accountants who are under the Minister of Finance. The Minister of Finance has supervision over the accounts of all the ministries and examines the statement of the accounts before they are forwarded to the Cour des

¹ United States Budget and Accounting Act (L. 20, 42 Stat.), 10th June 1921, C. 18, § 312, 42 Stat. 20.

² *Ibid.*, 10th June 1921, C. 18, § 313, 42 Stat. 20.

Comptes for final verification. Unfortunately these accounts are forwarded to the Cour des Comptes after a delay of several years. The verification, therefore, is ineffective since auditing should be prompt, *i.e.* it must take place quickly after the expenditure has taken place.

THE COLLECTION OF REVENUE

2. In the early days of society the collection of dues was not a complicated matter. As centralised Governments developed, the revenue was farmed and apportioned. This gave rise even in the Roman Empire to grave abuse, as it does in China to-day. The Zemindars in the permanently settled tracts of Bengal to-day are the descendants of the rent-farmers of the Moghul and early British period, when rent collection was entrusted to the highest bidder. Even to-day complaints are heard of exactions in the collection of the land revenue by the employees of landlords. The loss to the Treasury and the frequent hardship to the taxpayer are the main abuses of this system wherever it obtains. In a well-known passage in Sully's *Memoires* on the collection of revenue it is stated of his time in France that "in these times of confusion the royal funds were the prey of the one who grabbed them first. The revenues of the King were not sufficient for the avidity of the financiers, which ordinarily grew through public suffering. I had great troubles in unravelling the mysteries of the people of this profession. I discovered all the secret sources of the collectors. There were a large number; forgeries of pretended uncollectable debts, expenses for carriages, spices etc.; all these were so many resources used for the profit of the clerks who absorbed a portion of the revenue. . . . The contractors [*fermiers*] and the Treasurers of France realised almost twice as much as the sum for which the contract was given to them."¹ In the French Revolution the end of tax-farmers was a speedy one. A tribunal, for example, declared them individually and collectively guilty of malpractices and embezzlement, and, in Stourm's words, "as soon as the sentence of death was passed upon them they mounted the scaffold, twenty-eight of them, on the same day at five o'clock in the afternoon [8th May 1794]. Their stewardships were thus audited."²

¹ Cf. Stourm's *The Budget*, Plazinski's translation, p.538.

² *Op. cit.* p. 540

In England in early times the revenue was levied and collected principally by the sheriff of each county, who was an officer of great authority and power, as in Scandinavian countries. Up to the twelfth century he was practically a provincial viceroy not only in charge of finance but also of justice, police, and military matters. He was the vicecomes just as the earl was the comes of the county (*comitatus*). This title, a Continental one from Norman days, must not be taken as if it derived power from the earl or in any way represented the earl. He has been from first to last a distinctively royal official, a representative of kingly power, which the Norman Conquest greatly increased. The kings maintained their hold over the sheriffs in treating them as their officers and representatives who held their offices at the King's will. It will be remembered that in 1170, for example, Henry II. dismissed all the sheriffs of England and put others in their places. The ancient method of collection of revenue was the "Summonce of the Exchequer" which was issued twice a year in all the counties of England. At the Easter and Michaelmas terms the sheriffs and other accountants came to the Exchequer to render their accounts and pay their revenue dues. The King's itinerant judges, Justices of Assize, Justices of the Peace, and Lord-Lieutenants took over his duties, and not without reason since by the fourteenth century the sheriff was well hated, as he oppressed his county in order to make the most out of it. A series of statutes extending from 1354 to 1444 shows how Parliament attempted time and again to obtain annual sheriffs, a point which was gained in the fifteenth century. From this date onwards until the seventeenth century the office fell lower and lower and in later periods it was difficult to get sheriffs at all. When the sheriffs' powers as tax-collectors declined, or were curtailed, other provision was made for the collection of revenue. In addition to the sheriffs there were escheatours, foresters, the payers of customs, fermers, rent-collectors, and in later times collectors of tallages, dimes, and quinzemes. The money was paid at the Exchequer and deposited in one of the four large iron chests each of which was in the office of one of the four Tellers. These chests were secured by three large locks, the key of one lock being entrusted to the Teller, the second to the Auditor, and the third to the Clerk of the Pells. If the revenue was not paid in specie it was paid by

warrant of discount according to the usages of the time. No mistake or fraud in the Exchequer could remain long undetected owing to the fact that the officers were a mutual check upon each other and the money was in the same building. At the close of every day, every week, and every quarter or half-year the accounts in the Court of Receipt or Lower Exchequer were carefully checked and the totals compared to prevent errors. This system of paying into the Exchequer continued up to 1834. Sometimes the King's money was paid to him in his palace *in camera regis* or to his officers. But this was exceptional. The main principle was the regularity with which the revenue was accounted for at the Exchequer, and this system, centuries old, prevented mistakes or frauds. Other countries have their own system but the English system, extending over centuries, cannot be understood without a reference to its history.

From 11th October 1834 the revenue was paid into the Bank of England or the Bank of Ireland in accordance with sections 10 and 11 of the Exchequer and Audit Act of 1866, under which the different accounts were combined into what is known as the "Exchequer Account"¹ at the Bank of England. The great revenue departments such as Customs and Excise and Inland Revenue have, it must be remembered, their own accounts at the Bank of England, which are necessary before they can pay into the Exchequer account their net revenue, since immediately moneys are paid into the Exchequer account or Consolidated Fund they

¹ The Commissioners of Customs, the Commissioners of Inland Revenue, and the Postmaster-General shall, after deduction of the payments for drawbacks, bounties of the nature of drawbacks, repayments, and discounts, cause the gross revenue of their respective departments to be paid, at such times and under such regulations as the Treasury may from time to time prescribe, to accounts to be entitled "The Account of His Majesty's Exchequer", at the Bank of England and at the Bank of Ireland respectively, and all other public moneys payable to the Exchequer shall be paid to the same accounts, and accounts of all such payments shall be rendered to the Comptroller and Auditor-General daily, in such form as the Treasury may prescribe: provided always, that this enactment shall not be construed to prevent the collectors and receivers of the said gross revenues and moneys from cashing, as heretofore, under the authority of any act or regulation, orders issued for naval, military, revenue, civil, or other services, repayable to the revenue departments out of the Consolidated Fund or out of moneys provided by Parliament" (section 10). "All moneys paid into the Bank of England and the Bank of Ireland on account of the Exchequer shall be considered by the Governor and Company of the said banks respectively as forming one general fund in their books; and all orders directed by the Treasury to the said banks for issues out of credits to be granted by the Comptroller and Auditor-General as hereinafter provided, for the public service, shall be satisfied out of such general Fund" (section 11).

pass out of the control of the revenue departments. The system of collecting indirect taxation, such as customs and excise, is based on the principle that the officer who does the actual collection of the tax has a check brought to bear on him by another officer. In excise collections the officer reports the amount of the production, say in a distillery, to the surveyor of taxes, who assesses the taxpayer and raises a charge against the collector of the district who collects the assessment, an assessment which is communicated to the surveyor as well as to the central office in London. The taxpayer usually pays by a cheque drawn by the payer's bank or a cheque guaranteed by the bank. These amounts are paid into the account. The local collectors forward daily to the Bank of England to the account of the Commissioners of Customs and Excise sums not required by them locally for refunds and office expenses or similar purposes. The Commissioners in turn make over to the Exchequer account from their account the credits received from the board's collectors. The Commissioners also transfer to the account of the Accountant and Comptroller-General of Customs and Excise at the Bank of England sufficient amount on which the Accountant and Comptroller-General can draw to meet current expenses of the office and other expenses such as drawbacks of the department. Inland revenue is collected on similar lines. The Inspector of Taxes raises a charge against the collector and the collector collects the taxes and remits the surplus to the account of the Commissioners of Inland Revenue at the Bank of England. The Commissioners in turn transfer from their accounts periodically the proceeds of their collections to the Exchequer account. Income tax is collected on a slightly different system owing to the fact that the taxpayer is protected from official inquisition as the tax is controlled by private persons namely the District Commissioners of Inland Revenue. If, however, the taxpayer prefers to deal with civil servants, namely the Special Commissioners in London, in order that his affairs should not be known locally, he may do so. The assessment is done by assessors appointed by the District Commissioners and they are paid small fees. They are not Government servants. They communicate the assessment to the Inspector of Taxes for the district, but this as a rule means the inspector makes the assessment on returns of income made by the taxpayer and submitted through the District Com-

missioners. The Inspector of Taxes is a civil servant and is the backbone of the system. The Board of Inland Revenue appoints collectors in each parish or district to collect the taxes. The collector remits the amount to the account of the Commissioners of Inland Revenue at the Bank of England. The collectors in practice, although not in theory, are under the Inspector of Taxes. Theoretically they are under the District Commissioners. The Inspectors of Taxes, however, check these collections and prevent arrears. Post Office revenues, rents of Crown lands, and other sources of revenue are all paid into the Exchequer account, including the profits of the Mint.

We see, then, that the exceptions to the statutory rule that there must be only one central account to which all revenue is paid are the case of Customs and Excise, where drawbacks and rebates are necessary, and the case of Inland Revenue where deductions are permitted to meet expenses of collection as provided in section 10 of the Act referred to above. Once in a month a claim is made upon the Treasury for credit in respect of these expenses as grants have been already voted in the Budget for these purposes. The Treasury makes certain that the claims for credit from the Board do not exceed the grants by Parliament, and it makes formal issues to the account of the Board from the Exchequer account. At the same time the Treasury deducts the amount so issued from the credit voted by Parliament and debits these to the account of the Board kept at the Treasury, and the Board subsequently pays it back to the Exchequer account. Collectors in out-of-the-way districts are permitted to make use within their districts of local balances for such payments on behalf of other departments in the form of pensions, for example, for the War Office and Admiralty. A claim is made by the Board of Customs and Excise through their head office in London to the debtor department, and that department notifies the Treasury and the Treasury in turn writes the claim off the votes of the debtor department. The drawback of this system is obvious. It means large cash balances in the hands of collectors, with the result that a constant checking is essential by inspectors under the control of the Accountant and Comptroller-General of Customs and Excise. The British system of collecting revenue is far from being unique. Its characteristic is the check which obtains at various stages and the consequent difficulty in perpe-

trating frauds. The assessing officer does not collect the taxes and one officer is a check on another. The collection of revenue demands care and constant checking if the revenue is to be collected with efficiency and with safety.

In France there are the controllers, two or three per district, who go out for at least nine months in each year touring through the parishes which comprise the district. As one writer has said, these collectors, by their uniforms, by their associations, by the examination and diplomas required for their appointment, constitute a big body of officials. Similarly in India there are the collectors, the executive heads of districts whose function is to supervise the collection of Land Revenue in addition to their work as District Magistrates. All these officers have to be paid adequate salaries in order to enable them to be efficient and free from all temptation. In the case of indirect taxes the administration has to deal with a smaller number of persons, and the work is comparatively easy. A large staff, however, is required for preventing traffic by smuggling or illicit distillation, and it is false economy to cut down the excise preventive staff when it interferes with their efficiency. It means a loss of revenue to the State.

CUSTODY OF PUBLIC MONEYS

3. When the taxes are collected how should they be paid to the State ? The older practice was for the funds to be transferred in cash to certain offices or Treasuries up and down the countryside. In some countries, as in India to-day, this practice still obtains. India has 300 district Treasuries and 1200 sub-Treasuries, but the Reserve Bank, and where the Reserve Bank has no agencies, the Imperial Bank of India conducts the Treasury business wherever the latter has a local head office or branch office. When a payment has to be made to Government the payer pays in the money with a *challan* (which is usually bi-lingual and in duplicate, one part serving as a receipt for the amount and the other for record). When anyone has to receive a payment from Government he presents a receipted bill or cheque issued in his favour by a competent officer at a Government Treasury and obtains payment. This decentralisation of Treasuries is a feature of the Indian financial system and is in contrast with the centralised system.

that obtains in most countries such as Great Britain. Because of the size of India, which is the size of Europe without Russia, and because of the scarcity of banks and the branches of banks throughout India, the system is essential. In Great Britain the public receipts and payments are centralised in the Bank of England in London,¹ and there are no outlying State Treasuries. Previous to October 1834 the State Treasury was the Exchequer within the precincts of the palace of Westminster and the Bank of England took over the Exchequer duties in this respect only, as we have seen, on the 11th October of that year.² The Exchequer was relieved from the charge and responsibility of the custody of public moneys. The Bank of France conducts a considerable amount of work on behalf of Government, although, it will be remembered, in 1806 Napoleon refused to entrust to the Bank of France the functions of cashier of the State. “I want the State to be able to shift the Army without the Bank’s knowing, and the Bank would know if it were familiar with my needs for money.” The United States, like India, owing to the large extent of territory, has, in a modified way, the Treasury system, but now depends mainly on the country’s banking system. The Federal Reserve system has done much in regard to the management of public funds by developing banking on systematic lines. The independent Treasury system in the United States has given place to the Federal Reserve banks, where, for example, the gold which secures gold certificates is held in place of sub-treasuries. The Treasury vaults in Washington are still used for the storage of coin, bullion both gold and silver, and other public property. As in the case of the British Treasury, the Federal Treasury controls and supervises the collection of the revenue. In Great Britain, however, this is done through the departments which are subordinate to the Treasury, viz. the Boards of Inland Revenue and of Customs and Excise. Resource operations or distributing the cash balances of a country between the various centres so that each shall at all times have sufficient funds to meet its fluctuating requirements constitute a difficult problem. To move funds

¹ Moneys on Exchequer Account are paid into the Bank of England and in Belfast into the Bank of Ireland.

² In the Public Record Office at the end of the book of Receipt or Introitus of the Clerk of the Pells there is a note in pencil by a clerk after a summary in Latin of the receipts for the quarter: “a 5 die Julii ad 10 diem Octobris 1834” --“Diem mortis Seccarrii”.

from one place to another is a costly matter. In India a Paper Currency Reserve is distributed through the country in the various Treasuries by means of currency chests, and these serve as a useful means for transferring funds. The deposit of notes in a currency chest decreases the amount of notes in circulation, and the deposit of rupees in a currency chest increases the amount of coin in the Paper Currency Reserve. A deposit of coin or notes in a currency chest thus enables the issue of notes elsewhere up to the amount of the deposit. If a transfer of funds is necessary from Treasury X to Treasury Y, this can therefore be effected without actually remitting coin or notes by transferring money from the Treasury balance to the currency chest at X and transferring the same amount from the currency chest to the Treasury balance at Y. Bills and telegraphic transfers are also utilised for the transfer of funds by private individuals. The number of Treasuries thus necessitates in India a "resource" problem which means the constant task of distributing a cash balance varying by millions of rupees at different times of the year over three hundred main centres in India, and between India and the London Branch of the Reserve Bank according to fluctuating requirements. The large area and the large population necessitate or require a large delegation of executive authority which conditions these financial arrangements. The Reserve Bank and the Treasuries pay out moneys which are not State revenue or expenditure proper, especially in connection with the payments for crops. The Treasury Officer and the Treasurer open the strong-room of the Treasury daily when it is made over intact by the guard. Each officer has his own key and sufficient cash and currency notes (Reserve Bank notes) are withdrawn to meet the probable demands of the day. They are made over to the Treasurer and entered in his accounts. The strong-room is then again double-locked. As a general rule the various forms of currency—cash, notes, and stamps—in the hands of the Treasurer do not exceed at one time his security.

THE METHOD OF SPENDING

4. After the Budget has been passed by the legislature it is necessary, before the expenditure is incurred, to receive the necessary authorisation for that expenditure. This is the first

principle in the execution of the Budget, and the method of authorisation varies from country to country according to law and custom. In Great Britain, for instance, the procedure followed at the present time dates back very many centuries, indeed to Norman times. Before an issue out of the Exchequer for supply services can take place, a Royal Order is necessary. This is followed by a requisition from the Treasury to the Comptroller and Auditor-General, and this in turn by a grant of credit by the Comptroller and Auditor-General addressed to the Bank of England. This procedure is completed by a Treasury order to the Bank of England, an order which releases the credit. In regard to this procedure the Treasury is the chief authority, its procedure being regulated by the Exchequer and Audit Departments Act of 1866. The exact financial position is detailed in section 15 of the Exchequer and Audit Departments Act.¹ In the requisition for credit to the Comptroller and Auditor-General the Treasury uses the expression "we authorise and require you to grant to the Lords Commissioners of His Majesty's Treasury . . . credits". The Royal Order, which is signed by the King and countersigned by two Lords of the Treasury, authorises a grant to the Treasury for supply services from His Majesty's Exchequer at the Bank of England or the Belfast branch of the Bank of Ireland. For Consolidated Fund services a Royal Order is not required because money for these services is not granted expressly to the Crown, and the Consolidated Fund charges are imposed permanently by statute. Except for the Royal Order the procedure is mainly the same as in the case of supply services. At the end of every quarter the Treasury makes out a schedule of the amount required for these Consolidated Fund services. The requisitions for credit for the supply services are for lump sums, whereas requisitions for credit for the Consolidated Fund services are in detail. This Royal Order can be traced back to the time when the Exchequer was in Westminster and when the King, under the Great Seal or the Privy Seal, directed the chief Justiciar and Barons of the Exchequer, or usually the Treasurer and Chamberlain of the Exchequer, to make issues of money from the Exchequer. The writ began with the word "liberate", deliver ye, and from this the writ was called the "liberate". No document in those days was regarded as an authentic expres-

¹ 29 and 30 Vict. c. 39 s. 15.

sion of the King's command without the King's seal, which after the abolition of the chief Justiciarship in the middle of the thirteenth century was entrusted to the Chancellor, who was the chief secretary of all departments, and in Tudor times he was the equivalent of a Prime Minister. For matters directly affecting the King a Privy Seal was in use, and under this seal directions were given to the Chancellor as to the use of the Great Seal. In Tudor times the Royal Sign-manual was countersigned by the Secretary. In later times it was issued under the authority of the sovereign expressed by a Royal Sign-manual warrant or by letters patent or under the authority of the Privy Seal. The royal authority was issued through the Treasury, and in the Exchequer was recorded in the books of the Auditor and a second time in the books of the Clerk of the Pells. The Treasury warrant and Exchequer order were returned to the Treasury for signature, after which they were sent again to the Exchequer with a Treasury-issuing letter specifying the date of the issue and the funds out of which the order was to be paid. The necessary direction was written by the Auditor's Chief Clerk upon the Exchequer order and addressed to the Teller, by whom it was to be paid. This order was also entered in the Auditor's Issue Book by the Clerk of the Issues. The order was sent to the Clerk of the Pells to be recorded in his entries of issues, and finally to the Teller for payment. All moneys were paid at the Exchequer, including salaries and pensions, issues to the services, etc. The Exchequer books of record both of the Auditor and the Clerk of the Pells exist from the reign of Elizabeth down to 1834 in an unbroken series with many entries of earlier dates. The earliest entries were made upon skins of vellum made up in rolls. It is not realised how many documents the King has to sign, and how, were he to lose the use of his hand, a great deal of public business especially connected with the Budget would soon be in confusion. In 1811, for example, when George III. had a mental breakdown, no money could be got out of the Exchequer because the King could not sign the necessary warrant, and Parliament had to pass a resolution authorising and commanding the issue of money. In some quarters this resolution has been considered to be of doubtful legality. In 1830, when George IV. found it difficult to write, an Act of Parliament had to be at once passed authorising the use of a stamp to be affixed in

his presence to documents which require the use of the Royal Sign-manual.

In the Treasury order to the Bank, the Bank is requested to transfer to the Paymaster-General a certain sum from the Exchequer account. The office of the Paymaster-General is now but a shadow of what it once was. It is an unpaid political appointment and the work is done by a civil servant called the Assistant Paymaster-General assisted by principal clerks, nine heads of divisions, and other clerks. The Paymaster of the Forces, the Treasurer of the Navy, and the Treasurer of the Ordnance were combined in one Paymaster-General in 1836. Some of these offices dated back at least to the Restoration of 1660. A separate Paymaster of Civil Services took over the duties previously discharged at the Exchequer, but he in turn was merged in the Paymaster-General in 1848. The Paymaster-General is the paying agent for the different Government departments other than the revenue departments, and the Bank of England, under instructions from the Treasury, transfers a certain sum from the Exchequer account to the Paymaster-General's account and not to the account of a particular department. This avoids a number of separate drawing accounts for different departments at the Bank, and it keeps cash balances as low as possible and is necessary for the daily requirements of the public service. The concentration of balances is desirable because it is when balances are scattered and lying idle that defalcations usually take place. The departments draw issue orders on the Paymaster-General and they transmit to him daily the list of drafts, which he cashes through his central account when they are presented by the payees. A greater part of the payments made by him are made through banks to whose accounts the necessary transfers are made at the Bank of England. Cash payments, however, are also made up to £100 and the payments of pensions form an important part of the work of this office. It is perhaps unnecessary to go into detail regarding the several accounts which the Paymaster-General keeps at the Bank of England. His supply account or Exchequer credit account receives all receipts paid from the Exchequer and he meets his daily expenses from the drawing and bill accounts. From his drawing account cash payments and payments by cheque, by "writes off", and by sight drafts on himself are made, while out

of the bill account are met bills of exchange which he has accepted. From the supply account no more than is sufficient for daily needs is transferred to the drawing and bill accounts. In the case of revenue departments which have their separate accounts at the Bank of England, the Paymaster-General does not pay their salaries and expenses, as they do it themselves, as we have seen, from their own accounts at the Bank of England, but periodically the revenue departments have to adjust matters with the Exchequer by drawing from the Exchequer account at the Bank of England the amount of revenue used for expenses and they transfer the equivalent of gross revenue from their account at the Bank of England to the Exchequer account. It should be noted that the system by which the revenue departments keep back sums necessary for their expenses out of revenue and do not pay the total receipts immediately into the Consolidated Fund does not interfere with the control of the issues by the Treasury or by the Comptroller and Auditor-General. Parliament, in granting in the Budget sums for the payment of revenue collectors from the Consolidated Fund, controls these departments because they have to make monthly a claim on the Treasury for credit in respect of the amounts retained. If the Treasury refused to grant the credit to the revenue departments they would be obliged to make good the amount out of their own pockets, in other words without the authority of Parliament. The Board in other words would have to make good monthly what it has deducted for expenses. Payments for Consolidated Fund services, except those for the service of the National Debt (which is done by the Bank of England and the National Debt Commissioners), are made by the Paymaster-General. Imprests or advances for the King's Civil List are made to the Paymaster of the Royal Household and to the Keeper of the Privy Purse. All departments pay over to the Paymaster-General receipts from stores or any other moneys which they receive, and these are credited to the cash account of the Paymaster-General at the Bank of England. No payments are made out of this cash account. It augments the drawing and bill accounts when required. Deposits received by Government departments are credited to this cash account. The Paymaster-General makes, in short, disbursements on behalf of the various departments of the Government, and at the end of every month, more fully at the

end of every quarter, and still more fully at the end of every year these payments are reviewed by the Treasury and checked by the Comptroller and Auditor-General in order that they may agree with the votes of Parliament. It will, therefore, be clear that the Paymaster keeps a vigilant eye on the spending of various grants according to the votes of Parliament. He has to make a check to see that the wishes of Parliament are complied with. In addition to this check on spending there are the Treasury and the Comptroller and Auditor-General. The Paymaster-General makes no payments for any service until he has been notified by the Treasury that the money is available and a Royal Order has placed funds at the disposal of the Treasury. This order can be issued as soon as a vote has been passed in Committee of Supply and reported, even without the resolution in Committee of Ways and Means or the final statute.

The procedure in other countries is as a rule less complicated but in every well-financed administration the principles of authorisation and check are carefully maintained. The examples of France, Germany, and the United States have already been referred to.

In India the procedure is similar. The work of communicating grants to the disbursing and controlling officers is taken up immediately after the passing of the Budget by the legislature. Expenditure against appropriations is watched by dividing grants into primary units of appropriations, *e.g.* the pay of officers, establishment, contingencies, allowances and honoraria, supplies and services, grants-in-aid, contributions and donations, works, assignments, and compensations, establishment charges payable to other Government departments, refunds, reserve, suspense and expenditure in England. These appropriations are sometimes further subdivided for purposes of financial control. Appropriation is in force only until the close of the financial year, and this requires considerable control to avoid extravagance and a rush of expenditure in March. Before any expenditure can be incurred both administrative sanction and Budget provision are required. Neither the one nor the other is by itself sufficient. Engineering works require in addition to administrative sanction and Budget provision what is known as technical sanction or the approval of plans and estimates. The watching of the actual expenditure rests with the head of

the department. The Accountant-General in each province communicates with the Finance Department if the rate of expenditure proceeds at a rate which is likely to exceed the Budget amount. A review of the estimates for the current year takes place four times annually, once after three months, the second after six months, the third and fourth being the Budget forecasts mentioned in a previous chapter. Before payment is made of Government moneys the same vigilance has to be exercised by an officer as he would do in respect of expenditure of his own private money. The paying agent has to see that the authorised amounts have not been exceeded, that the documents for each claim are genuine, and that a receipt in due form is given.

ACCOUNTS

5. Here again a country's accounts depend on history, and the excellence of the English accounts is perhaps due to the fact that even in Norman times great care was taken with their compilation. The Great Roll of the Pipe or *Rotulus Annalis* which gives the accounts as far back as 1132, is a stately record of Government accounts giving the details of the revenues and debts due to the Crown. In addition to this are Memoranda, Plea Rolls, and the *Rotulus Cancillarii*, the counter-roll of the Great Roll which in the fourth year of Edward I. was known as the *Primus Rotulus Scaccarii*. A complete record of receipts and issues, known as the Exchequer Books of Record, from the reign of Elizabeth down to 1834, now in the Record Office, is a mine of information to students interested in the history of public finance. The Treasury Minutes from the Restoration are of special interest.¹ In the nineteenth century, especially from 1866, a system of accounts has been evolved which, in spite of unnecessary and out-of-date procedure connected with them, has won the admiration of most countries in the world.

In recent years States have given considerable attention to the science of accountancy. Double-entry book-keeping and costing are two examples of what should be followed where possible. The advantage of double entry is that each entry is controlled by a similar entry elsewhere, and it will be necessary

¹ Vide *7th Report on Public Records*, 1846, containing the report upon Treasury Records.

to commit two errors of the same magnitude in order to avoid showing the error in the accounts. Costing applies particularly to the Public Works Department—a department which has in most countries a reputation for extravagance. It is also essential to see that revenue and capital accounts are kept separate, in order that the two do not overlap. The accounts should be classified in such detail as to secure uniformity of accounting, to render possible a comparison between figures for different periods and localities, to facilitate the preparation of Budget estimates, and above all to ensure effective financial control, combined with economy, by means of a periodical review of receipts and expenditure entrusted to disbursing officers. It is usual in most countries of importance to compile the accounts by stages.

In India, for example, the method of classification and compilation of public accounts consists of four stages : (1) the monthly compilation by the district treasuries and certain departmental officers, (2) the monthly compilation by the Accountants-General, (3) the monthly compilation for the whole of India by the Controller of the Currency for certain heads of account, and (4) the annual compilation of a consolidated account by the Auditor-General for the whole of India. The accounts are also in considerable detail in order to show the principles enunciated above. Thus there are 13 groups under revenue, 17 under expenditure, and 10 on each side under different heads. The groups include (a) principal heads of revenue, (b) railways, (c) irrigation, etc. These groups are subdivided into major heads, of which there are about 42 under revenue, 59 under expenditure, and 60 on each side under debt and remittance. Major heads are subdivided further into minor heads, of which there are 400 in regard to revenue, nearly 500 in regard to expenditure, and several hundreds under debt and remittance. These are subdivided into detailed heads which run into thousands. Under the Constitution revenue and expenditure are classified into central and provincial and non-votable and votable expenditure.

The main objects of public accounts are the affording of security against the negligence of accountants and the means of giving promptly and without difficulty information upon the several parts of receipts and expenditures of public moneys. It is, therefore, necessary to avoid confusion and for this purpose

the accounts should be cash accounts. The Budget of one year follows another in continuous succession and there is no value to be obtained from these laborious and fine adjustments. Cash accounts are simple and it is for this reason that most countries adopt this system. Another principle is that when Government must keep trading accounts they should be kept as prescribed in the British Exchequer and Audit Departments Act of 1921, which enacts that "there shall be prepared in each financial year in such form and by such Government departments as the Treasury may from time to time direct or approve, statements of account showing the income and expenditure of any ship-building, manufacturing, trading, or commercial services conducted by the department, together with such balance-sheets and statements of profit and loss and particulars of costs as the Treasury may require". It is also prescribed by this Act that the Comptroller and Auditor-General must examine all such accounts in order to see that the programmes of expenditures have been laid before Parliament. The question of cost accounts has been referred to in Chapter XXXVIII., and as there stated should be confined only to those Government accounts where commercial concerns of a public utility nature are undertaken by Government. Appropriation accounts are useful as showing whether the money granted by Parliament has been spent as Parliament directed. Every spending department in Great Britain renders an appropriation account. Section twenty-two of the Exchequer and Audit Departments Act of 1866 provides that the department charged with the expenditure shall prepare the appropriation account, but by "department" is meant any public officer to whom the duty may be assigned by the Treasury. The Treasury has entrusted this work to a special officer and the Public Accounts Committee, and Parliament also has enforced this arrangement.

CONTROL OVER ISSUE

6. A reference has been made above to control, which was divided into administrative, judicial, and legislative.

Administrative control is exercised not merely by heads or subordinate officers but by the department of the Government controlling these officers. The Treasury or the Finance Department also controls and raises objections to proposed expenditure,

and draws attention to facts and considerations to which sufficient weight has not been attached. Its consent should be obtained before any expenditure involving any new principle is sanctioned. No expenditure in excess of the estimates should be incurred without previous consultation with the Finance Department. Any proposal involving an abandonment of revenue of which credit has been taken in the Budget, or involving expenditure for which no provision has been made in the Budget, should be submitted for the consideration of Government or the legislature without the previous reference to the Treasury or the Finance Department. The watchdog of finance must be regarded with awe by the other departments of the administration. The most effective control, however, is always within the department itself, as it is more intimately connected with the details of essential and non-essential expenditures, especially during a period of depression and of severe economy, than the Treasury or Finance Ministry. The Accounting Officer within the department is also able to exert considerable influence on the control of expenditure. The Accounting Officer for each department is selected by the Treasury, and every payment from the vote is made on his responsibility. He has to see that each payment has the authority firstly of his own department, secondly of the Treasury, and thirdly of Parliament. He is bound, as everyone else in the department is, to act on instructions from the head of the department, but he can in certain cases protest against the order, which he nevertheless must obey. If he is instructed to make a payment which he believes to be irregular it is his duty to call attention to the fact, and, if overruled by the head of the department, he must insist on having written instructions and must record his opinion in writing. If he did not do this he would be considered as responsible for the improper payment. In many cases the Accounting Officer is the permanent head of the department who can be overruled by no one except the Minister himself. In the largest departments the chief financial officer is inferior to the permanent head, but has the advantage of knowing the financial organisation of the department, and the permanent head would not in such cases overrule the Accounting Officer without referring the matter to the Minister. In one or two cases the Treasury has placed an officer in a large spending department with certain delegated

powers from the Treasury. Sometimes an officer of the Treasury is attached to another ministry but is responsible to the Treasury alone. An instance of this sort is the case of an officer of the Treasury attached to the Ministry of Transport. The Comptroller and Accountant-General of the Post Office is an officer of the Post Office and not of the Treasury. But the concurrence of the Treasury is usually taken before an appointment is made and the Treasury can rely on the co-operation of this officer. Below the Accounting Officers there are sub-accountants who receive advances of money or imprest from the vote in order that they may meet disbursements chargeable to the vote, as in the Navy where the officers have to meet payments. The sub-accountant sends in an account monthly and, unlike the Accounting Officer who signs the order on the Paymaster-General by which the money is obtained, he is in actual possession of the money. His accounts and balances moreover are checked by his own department, and it is only when these are checked that they are passed on to the auditors for audit. The audit is conducted concurrently as far as possible with the expenditure. This is a practice followed in most countries so that each month's accounts are submitted to the auditor as soon as they are ready, and this avoids the delay which would occur where the accounts are submitted once a year. The Treasury certainly has enormous powers of control, but the weakness in such control is that after its sanction it may continue from one generation to another when the necessity for it no longer continues. If the spending department takes the initiative, well and good ; if it does not, it goes on year after year. Departments are often great sinners in this respect, as they never will give up staff willingly even after it is found the work is less heavy than was anticipated, and when staffs are redundant the head of the department is likely to say that unforeseen contingencies make it essential to have a little reserve up one's sleeve and so to avoid approaching the Treasury for permission for more. No officials, however able, in any Treasury or finance department, even those connected especially with establishments, can have the knowledge of what is going on in different parts of a province or State, and therefore in such circumstances cannot really have any very effective check upon waste. A former Chancellor of the Exchequer said with much truth that "the real control is exercised first within each depart-

ment by its own officers ; secondly by the Treasury, and lastly in case of serious difference of opinion, by the Cabinet ”.

Administrative control should be in all senses thorough, and the Audit Department itself should have its accounts audited by an outside agency. In the case of the Exchequer and Audit Department in Great Britain, for example, the accounts are audited by a Treasury official who receives the accounts of the department monthly. Similarly the Paymaster-General's disbursements are reviewed by the Treasury and checked by the Comptroller and Auditor-General.

The Treasury in its Minute of April 1868 has defined the sphere of Treasury sanction in directing the Comptroller and Auditor-General to bring to the notice of the Treasury any excess of charge beyond the amount assigned to each subhead. It further insists that Treasury sanction must be given “ for any increase of establishment, of salary, or of cost of a service, or for any additional works or new services, which have not been specially provided for in the grants of Parliament ”. The Comptroller and Auditor-General must report any unauthorised expenditure. It remains with the Treasury to obtain Parliamentary authority in the supplementary estimate or otherwise for any expenditure connected with the financial programme of the Government during the year. The powers rest with departments to reappropriate within limits, and the Treasury or the controlling financial department itself may have larger powers. But it is customary to report important reappropriations for subsequent sanction of the legislature, a sanction for reappropriations which the departments cannot under the rules grant. It must always be remembered that the control of the Treasury is of two kinds. In the first place it has to see that the financial policy of the Government is carried out. In the second place it is responsible for ensuring that Parliamentary authority is completely complied with. It is not always possible to control every item of expenditure from the Exchequer because grants paid over in the form of grants-in-aid or payments to local taxation accounts cannot be controlled by the Treasury once they are paid.

Judicial control is exercised chiefly in France. It was founded by Napoleon in 1807, and “ it is ”, as one writer points out, “ a veritable court of justice, which has for its object to verify the actions of the accountants, to discharge them from

their responsibility in case their management is regular and correct, or to place to their charge any balances they may be owing through fraud, imprudence, or infraction of rules; in such cases the Court of Accounts pronounces judgment".¹ It does not encroach on the administration. For example, accountants make payments on orders received from superior authority. The Court of Accounts does not dispute these payments. The *Cour des Comptes* is not a branch of the administration, but an independent judicial body; it bases its criticisms on documentary evidence only. It works on closed accounts, and exercises no preventive control, and it bases an opinion on the action of Ministers only after examining the individual accounts of accountable officers. Its judicial powers were conferred by Napoleon I. on its creation in 1807, and its reports to the legislature on the appropriations as set out in the Budget law have been called for since 1831. It may be said that it combines the two main functions of the Comptroller and Auditor-General in the English system although it differs from it in that it is a judicial body.

Legislative control is that exercised by the legislature usually through committees, as in the Committee of Public Accounts of the British House of Commons appointed annually since 1861, at the beginning of its session for the examination of accounts. The number of members of the Committee is usually 15. The Committee examines the preliminary grant for each financial year, including supplementary grants, with a view to seeing whether the grants Parliament passed have been properly applied. It also scrutinises any excess overgrants or bad spending on the part of the Executive. Its researches are published and are an effective means by which the House of Commons controls Government expenditure. The findings of the Public Accounts Committee are based on the Audit and Appropriation Reports submitted by the Comptroller and Auditor-General. In Section I. of the British Exchequer and Audit Departments Act, 1921, it is provided that the Comptroller and Auditor-General shall report to the House of Commons any important change in the extent or character of any examination made by him. This includes revenue and stores accounts in addition to accounts of

¹ Fisk, *French Public Finance*, p. 224 (Bankers' Trust Company, New York, 1922).

expenditure, which alone used to be scrutinised previously. A day is sometimes allowed in the House of Commons for a discussion of the Report of the Public Accounts Committee, and in this way the House of Commons satisfies itself that its appropriations are properly utilised. The presence of the Auditor-General and of a Treasury official at the meetings of the Public Accounts Committee of the House of Commons raises a principle which is of importance in regard to legislative control, namely that the presence of permanent officials is necessary if the work of such a Committee is to be carried out successfully. It is the Auditor-General who brings to notice most of the delinquencies of the year and starts the hunting of the hare, and the advice of a Treasury official is, as experience has shown, of very great value. When the Committee has decided any matter it remains for the Treasury to follow it up, and rarely if ever does the Treasury disagree with the Committee, and so the House will certainly support whatever action is taken. Indeed as one writer expresses it "where the Committee has roared as mildly as a sucking dove, the Treasury roars like a Libyan lion".¹ It has, sometimes, been suggested that the Legislature should have a permanent officer and staff to go about and inquire into the staffing and working of departments in order that waste and extravagance throughout may be checked. The functions of the Comptroller and Auditor-General in Great Britain are restricted to matters arising out of accounts and he cannot undertake a campaign of retrenchment in any office. It has sometimes been suggested that the legislature requires an official who would discover whether there is a lack of co-ordination in the public service, waste, and extravagance and to report this to the House of Commons in order that it may have a better control over expenditure. The objections usually put forward to this are that it would weaken ministerial responsibility and interfere with Treasury control. On the other hand, Ministers of spending departments require the greatest possible control and the Treasury has never, as we have seen, been enabled to exercise an adequate check on, for example, the demands of the fighting services. Committees on national expenditure which are appointed *ad hoc* in times of depression or in a crisis, such as the Geddes and May Committees,

¹ E. Hilton Young and N. E. Young, *The System of National Finance*, 2nd edition, p. 131.

invariably bring to light extravagance and the existence of staff for the work which has outgrown its usefulness. The necessity, therefore, of some such control by the legislature in many countries requires the most careful consideration in order to avoid the incredible waste that sometimes occurs in Government services as in joint-stock businesses. There is in the legislature of France a Commission for the verification of the accounts submitted by the Ministers. It is composed of members chosen from the Senate, the Chamber of Deputies, and the Court of Accounts. The Commission examines the accounts of the executive officials who authorise expenditure, the Ministers' annual accounts, and the work already completed by the Court of Accounts, a judicial body. Its control over expenditure is undoubtedly far-reaching. In India legislative control is exercised through the Committee on Public Accounts appointed by rules made under the Government of India Act, 1935. It is customary in all provinces and in the Central Legislature for a Finance Committee¹ to examine expenditure before it is submitted to the legislature, but this is not to be confused with the Public Accounts Committee. The duty of the Public Accounts Committees is to see that the money voted by the legislature has been spent within the scope of the demand, and that every re-appropriation from one grant to another or within the same grant, and all expenditure which the Finance Committee requests to be brought to the notice of the legislature, are duly brought forward. The Committee also summons and examines officers responsible for the appropriations in question. The Auditor-General submits two reports, (1) the audit report, and (2) the appropriation report. The first deals with the audit and the second with appropriation. In March of the succeeding financial year the Auditor-General submits an annual appropriation report, which forms the basis of the discussion of the Committee on Public Accounts. The Committee on Public Accounts submits the report to the legislature, which can make recommendations. The Executive ordinarily gives effect to these after due consideration. Experience has shown that the most common irregularities are the withdrawal of money before the completion

¹ The Finance Committee has no statutory basis. It originated in pursuance of the recommendation made in paragraphs 235 and 285 of the Montagu-Chelmsford Report (Cd. 9109, 1918).

of works or in advance of requirements, a rush of expenditure in March to avoid lapse of grants, the postponement of inevitable payment, unusual expenditure, losses resulting from disregarding rules, double payments, or the manipulation of accounts with fraudulent intent and embezzlement.

AUDIT OF ACCOUNTS

7. The word "audit" indicates the long historical associations which lie behind it. When an examination of the accounts was held at the Exchequer it originally consisted of "hearing" of explanations from the individual person or persons rendering the accounts. The barons of the Exchequer compelled those who received moneys from the public to pay into the Exchequer the proceeds and to furnish accounts. Those who received advances (or imprests) out of the Exchequer had to render accounts. The accounts were audited by persons specially appointed for that purpose, by the King or the Treasurer and barons of the Exchequer. In due course these auditors became permanent officials at the Treasury for this purpose, and these were called Auditors Comptotorum Scaccarii. With the decline and fall of the sheriffs in financial matters we see the collection of revenue and the audit of the accounts entrusted to other hands. This decline went on continuously for centuries. In 1225 the fifteenths, like other fifteenths and thirtieths granted by Parliament, were collected by special justices and no longer accounted for by the sheriffs or recorded in the Great Roll of the Pipe. The accounts of the fifteenths were then audited by the Bishop of Carlisle, Michael Belet, and William de Castellis. In the reign of Edward II. audit seems to have been well established, as the post of auditor of the Exchequer was in existence in 1314, and in 1310 and 1311 the proceeds of all taxes, including customs, were to be brought into the Exchequer, and this shows that the Court of Exchequer had already become a Court of Audit. In the reigns of Edward III. and Richard II. there were constant complaints of the absence of auditing the national accounts, and audit was mixed up with the baronial struggle to take out of the King's hand the power of spending public money. Parliament was desirous to determine the way in which the grant should be applied and to secure the efficient audit of accounts by the appointment of responsible

Treasurers for each subsidy. In 1340 an audit was required by a Committee of Lords and Commons in regard to the receipts of William de la Pole, and in 1341 they demanded that certain persons should be appointed by commission to audit the accounts of those who received the subsidy of wool and other aids granted to the king, and also those who received and spent on both sides of the sea public moneys since the beginning of the war. In 1376 and 1377 audit was again demanded in order that the money might be applied entirely to the expenses of the war and in no other way. In 1379 the king ordered the accounts of the subsidy to be presented by the Treasurers and in 1381 the whole procedure of the Exchequer seems to have been reformed since from this period onwards accounts were rendered for both receipts and issues. In the time of the Tudors we find auditors of the Imprests who date from the second year of Queen Elizabeth. Two auditors, independent of each other with separate offices and clerks, were appointed by letters patent and held their offices during good behaviour. A general imprest roll was furnished every half year by the auditors to the Exchequer. When these auditors' accounts were submitted to the Treasury both copies were signed by the Chancellor of the Exchequer and other officers of the Exchequer. One copy, the "declared account", was preserved at the Exchequer and the other, called "the account", written on parchment, was taken to the office of the King's Remembrancer and the Lord Treasurer's Remembrancer and then to the Pipe Office, where it remained and from whence the accountant got his acquittance. Auditors of the land revenue were appointed as early as 1511. In the time of the Stuarts the principle of appropriation that "supplies granted by Parliament were only to be expended for particular objects specified by itself" was disputed, but from the reign of William III. and Mary it was carried into full effect, since a clause in the Appropriation Act prohibits under severe penalties the issue of any money except in the way specifically appropriated by the House of Commons. This gave the House of Commons a control over the Executive and marks the transfer from the Crown to Parliament of the power over the purse. Since this time onwards the niggardliness of Parliament to sovereigns was a thing of the past and Europe saw English Parliaments profuse in their grants.

In 1780, as we have seen, the Commissioners of Public

Accounts were appointed and they found that the audit was for many years in arrears. In 1785 the two auditors of Imprests were abolished and in 1799 the powers of the Board of Audit which took their places were extended and the auditors of land revenue were abolished. Further changes were made in 1806 when by Act of Parliament¹ the system of audit of public accounts was established, a system which continued up to the year 1866 when the Board of Audit was abolished and its powers transferred to the Comptroller and Auditor-General.²

An adequate audit, however, may be said to have been in force in the early nineteenth century so far as the Government was concerned. The accounts of those persons who received and paid moneys were audited ; but from the point of view of the Ministers ultimately responsible, it was an audit on behalf of the Government. It had nothing to do with the responsibilities of Ministers to Parliament. In 1832, therefore, the first appropriation audit was introduced and at first applied only to Navy votes. The auditors had to ascertain that receipts and payments recorded in the accounts conformed to the facts and to proper official authority. In addition to this there was the novelty of appropriation audit that they had to ascertain that all the payments were in accordance with Parliamentary votes and that the totals, therefore, of those votes were in no case exceeded. In 1846 the appropriation audit was applied to the Army and Ordnance votes, and in 1866 it was applied to Civil votes, and thus the security for appropriations in accordance with votes of Parliament was achieved. These facts have been given in order to illustrate the principle that auditing public accounts is a very old one, and it is only within the last century that Governments have realised the vital necessity of a careful and complete audit of all accounts both from the point of view of administration and of appropriation. It has been realised that audit must be placed in a position of independence and several countries have incorporated this, as we have seen, into their Constitutions, as in the Government of

¹ 46 Geo. 3, c. 141.

² For a history of the audit of public accounts see 22nd Report of the Finance Committee, 1797 ; the 5th Report of the Committee of 1810 (No. 371 of 1810) ; the 10th Report of the Committee of 1811 (No. 253 of 1811) ; the papers relating to the Audit and Naval and Military Accounts (No. 160 of 1856) ; the Evidence and Papers appended to the Reports of the Committee on Public Monies in 1856 and 1857 ; and the annual Reports of the Public Accounts Committee, especially of 1858 and subsequent years.

India Act 1935,¹ or by act of the legislature, as in the American Budget and Accounting Act of 1921, where the Comptroller-General and the Assistant Comptroller-General are, like the British Comptroller and Auditor-General, given great security of appointment and independence.

The Auditor-General's functions are generally to watch, inquire, and to report. He is to investigate independently accounts and to extract from them the complete truth. He sees that appropriations are made precisely in accordance with the votes in the House of Commons, and has as a rule a large body of officials working under him in various offices and in various centres checking Army, Navy, Air Force, and other accounts daily, monthly, quarterly, and yearly. It is impossible to cover the whole field, as this would require an enormous staff. A test audit, therefore, of only a period or portion of the accounts, is undertaken. The British Act of 1921 makes it possible for the Auditor-General to dispense with a complete audit. Appropriation audit sees that the money is spent in accordance with the Appropriation Act or Acts—in other words, in accordance with the vote of the legislature. Administrative audit brings to light cases of fraud as well as of wasteful expenditure, and this form of audit, although important, has its limitations, as the Auditor-General cannot have the intimate knowledge of the working of a department specially a technical department with which, for example, the War Office and Admiralty are concerned. The object of audit is the detection of fraud, the detection of technical errors (*e.g.* the failure to sign a statement in the proper form) and also errors of principle (*e.g.* the incurring of expenditure without proper sanction and adequate appropriation, and the bringing of these prominently before (1) the executive and (2) the legislature, the twin guardians of financial propriety). Of these the detection of fraud and errors of principle are the most important. The spirit of audit and its interpretation should be liberal. The interests of the taxpayer should be protected, revenue increased, expenditure economised, and disbursing officers assisted. This is more useful than showing every trifling infringement of rules and regulations, which often results in unnecessarily protracted correspondence. If two rules are conflicting the more fundamental of them should be followed. The ideal auditor

¹ Government of India Act 1935 (25 & 26 Geo. V.) sections 166 to 171.

should, in fact, be one who asks every question that may be expected from an intelligent taxpayer bent on getting the best value for his money. In many countries there is in addition to audit of expenditure a careful audit of receipts. The business of auditing revenue receipts is especially difficult, as it is not always clear whether the records show all the receipts or whether all proper claims are being enforced by the department concerned. The Auditor-General arranges for this class of audit only in cases in which it is so required by the Government of India. The Civil Audit officers perform this duty in a small number of cases only. The audit of railway earnings, however, is an exception to this rule. It is essential to remember that a great deal depends on the initial examination of vouchers, and of receipts for expenditure. On this depends the utility of further checks and re-checks. It is important for every audit officer to see that in auditing accounts there are (1) sanction by the competent administrative authority, and (2) appropriation of necessary funds granted by the legislature. In the audit of stores it is advisable to see that the accounts of receipts of stores and of issues and balances are correctly maintained, and that steps are taken to dispose of unserviceable and surplus stores. The rates paid for stores should agree with those mentioned in the contract or agreement entered into with sellers, and there should be proper sanction for their purchase. In public works audit muster rolls or the list of labourers of those employed daily on works have also to be carefully scrutinised to prevent fraud, which sometimes occurs in the most surprising of ways. In audit there is not infrequently the danger of the machine becoming master of the man, not the man the master of the machine. This should sedulously be avoided, and dilatoriness must never be regarded as an equal virtue with despatch. If audit is dilatory it loses much of its effectiveness and it must be conducted with common sense and responsibility. A Treasury official tells how he went to Egypt with Lord Kitchener to improve the financial administration of the country and he found the audit office was not discovering errors in the public accounts. He went and sat down by the first official in the Egyptian audit office that he met and saw that he was auditing the accounts of the prison department for one month for some years previously. He had a list near him of the number of items which were to be examined and opposite these was the name of the person who received the pay-

ment. There was a bundle of receipts and vouchers showing how the amount was made up and how it was paid. He informed this Treasury official that he took only 25 per cent of the items and only special numbers, namely 1, 5, 9, 13, and so on. He was asked whether he varied them from day to day and from month to month, and the reply was "No, we never vary them. It is a rule of the Service always to take those items." No wonder that irregularities could not be discovered when this method was known throughout Egypt and also when only 25 per cent was to be examined, the remaining 75 per cent escaping audit altogether. As the writer said, "There you had the Audit Office, with its officials going round like squirrels in a wheel, producing nothing of value, but rather creating a false sense of security in the minds of those who were relying upon it, with nobody aware why it was a costly sham until somebody was able to get down to rock bottom and look at what was going on, and see the facts and figures ".¹

Financial administration which has been built up after centuries of scientific elaboration is a machine worked by perhaps the most upright and highly specialised engineers in the world. There is sometimes a danger of the many wheels in the machine retarding each other's progress : so many written rules to be observed that the spirit is sacrificed to the letter. Financial administration must needs be cautious and reasoned, but there is no ground why it should not be also firm and prompt.

¹ Henry Higgs, *Financial Reform*, Macmillan & Co., London, 1924, p. 40.

CHAPTER XLI

THE CENTRAL BANK

IN the previous chapters we have seen how important a part is played by the pivotal bank of the country in financial administration. The management of the public debt, the daily collection of revenue, and the paying of government obligations necessitate an enormous amount of work. The Bank of England with its branches in eight cities, and the Bank of France with about 660 branches, perform many services for the government. In 1934-35 a chain of British Empire central banks has been formed, and this co-ordination of Empire monetary policy and technique may have important results. Central banks have been created in New Zealand, Canada, and Australia, and recently the Commonwealth Bank of Australia has been transformed into a central bank. The South African Reserve Bank, the doyen of the Empire central banks, was founded in 1920. In China, too, the Government-owned central bank has been reorganised as a central reserve bank to maintain the stability of Chinese currency. The vastness of the work done by the Bank of England may be gauged from the fact that its staff apart from the printing factory, which before the War was approximately 1000, was in 1930 about 3800. The work connected with the collection of government revenue and with payments from the Exchequer account is heavy. There are on the books of the Bank upwards of three million separate stock accounts quite apart from the very large holdings of bearer securities. In connexion with the debt and other stocks it is probable that there are during the year between nine hundred thousand and one million transfers, approximately five million dividend warrants, and probably over five million coupons. The amount of notes that are issued in the course of the year is about 650 millions. The whole of these warrants, coupons, notes, etc.,

are printed in the Bank's own factory. The Bank of England in the first place is in charge of the National Debt. Adam Smith, writing over one hundred and sixty years ago, said that the Bank acts not only as a bank but as "a great engine of state". It not only undertakes the issue of all Governmental loans, including Government guaranteed loans, manages the stocks, and pays the dividends, but it also conducts drawings, transfers, registers, and performs all the ordinary work which a Registrar would perform. The Bank is also the custodian of the Government balances. It is the Government banker in another sense. It provides overdrafts known as the Ways and Means Advances, which, however, are never of any large amount, except for a short time on the first of June and first of December when large war loan payments are made. The Bank again acts as a Government agent in the weekly sale of Treasury bills, but always in the presence of a representative of the Treasury who determines the amount to be sold, but the Bank's advice is always freely at his disposal. The inner cabinet of the Bank of England is known as the Committee of Treasury—a significant name—and it consists of nine members. The Governor and the Deputy-Governor are *ex officio* members, but the remainder are elected by secret ballot from the twenty-four directors, and are in close touch with financial affairs from the City, the Treasury, and the world financial point of view. The Court of Directors itself meets weekly.

The twelve federal reserve banks in the United States with their twenty-five branches and supervised by the Board of Governors of the Federal Reserve System¹ with extensive powers of control over policy, expenditures, and personnel, perform many services on behalf of the Government. They

¹ *Vide* section 203 of the Banking Act of 1935—Public No. 305, 74th Congress H.R. 7617, "An Act to provide for the sound, effective, and uninterrupted operation of the banking system, and for other purposes". Under the Act the Governing Board is given greater authority, and there has been a concentration of responsibility for national credit policy. Open market operations are under a Committee consisting of the Board of Governors and five representatives of the Federal Reserve Banks. The Board of Governors, however, has authority over the other major instruments of credit control, namely, changes in discount rates, in Member banks' reserve requirements, and in margins to be prescribed for loans on securities. The Law of 1935, in short, preserves the local autonomy of the original banks in their relations and dealings with the Member banks in their respective districts, but places the ultimate responsibility and the main burden for the national credit policy upon the Board of Governors in Washington.

are the receiving and disbursing agents and have replaced the sub-treasury system. For a long time during the last century the United States preferred the independent treasury system rather than deposit their funds in banks. During the Civil War the Government was obliged to re-establish its banking connexions and, while maintaining the sub-treasury system, deposited funds in the national banks. Under the Federal Reserve Bank Act of 1913 provision was made for transferring the fiscal functions of the sub-treasuries to the federal reserve banks, the sub-treasuries being abolished with effect from 1st July 1921. But as early as 1915 Government funds were placed with the reserve banks, and later, arrangements were made that the collectors of customs and collectors of internal revenues in the twelve federal reserve bank cities should deposit all their funds with these banks. The banks were also paying a large proportion of Government cheques and warrants. The work of the federal reserve banks as the Government banker is well summed up in the Report of the Secretary of the Treasury of 1918 when he said that "The federal reserve system has been of incalculable value during this period of war financing on the most extensive scale ever undertaken by any nation in the history of the world. It would have been impossible to carry through these unprecedented financial operations under our old banking system. Great credit is due to the federal reserve banks for their broad grasp of the situation and their intelligent, comprehensive co-operation." Kemmerer, commenting on this, adds that "One shudders when he thinks what might have happened if the war had found us with our former decentralised and antiquated banking system. Think of pouring the crisis of 1914-18 into bottles that broke with the crisis of 1907!"¹

The federal reserve banks now act as the Government banker, and are performing the same functions as other central banks. They do the work connected with the public debt, the collection and disbursement of public revenue, and all similar duties except those which continue in the hands of the department of the Treasury at Washington mainly for reasons of historical sentiment. Even with differences of administration the federal reserve system does not work very differently from that of the Bank of England.

¹ Kemmerer, *The A B C of the Federal Reserve System* (Princeton, 1929), p. 103.

There is an essential similarity in the problem and in the methods of central banking management in both cases. There is, however, a great contrast between the New York money market and the London money market. The main demand for credit in New York from 1922 up to the end of the trade boom in 1929 was for financing the purchase of securities. This growth in credit could not have taken place in London, because the joint stock banks wisely preserve in their balance-sheets certain ratios among the different types of investments and assets which they hold. In the New York money market surplus funds flow to the stock-broker, while in London they flow to the bill broker. In New York there is no discount market which can handle the large volume of commercial and Treasury bills which is handled in the London money market. In the United States, bankers' bills are carried for the most part by the federal reserve banks or with foreign money. In London, issuing houses face mainly outward and abroad while in America similar houses face towards the interior. There is no active discount market such as obtains in London, so that the relation between the bill market and the central bank is different. In New York the member banks borrow directly from the reserve banks instead of calling money from the market and so forcing the market into the central bank as is the case in London. The New York market is unable to perform its function as an international money market with the steadiness and regularity of the London market largely because credit demands, dominated by the domestic trade of the country and the stream of investment which might otherwise flow abroad, are dammed up from time to time. On the whole the London money market can be more easily controlled than any other money market in the world. Other central banks in the various countries of the world perform similar functions as Government banker.

It is characteristic of a central bank to be independent of the Government but to be in close touch with it. The Board of Governors in Washington and the twelve reserve banks which are under its direction are in close contact with the Government. The Reserve Bank of India, for example, is in close touch with the finance department of the Government of India, and the Governor of the Bank keeps in closest touch with the Finance Minister in Delhi. The closeness and cordiality of this connexion

between a central bank and the Government are well summed up in the words of the Deputy-Governor of the Bank of England before the Macmillan Committee on Finance and Industry : “The Bank of England is in daily touch with the Treasury, sometimes many times a day. Probably twice in the week—if circumstances require it may be oftener—the Governor himself will pay a visit to the Treasury, sometimes accompanied by myself. When he is away, I pay such visits in his place. We have no secrets from them, we keep them fully acquainted as to the general trend of affairs in the City and the outlook, as we see it. We, on our part, never venture to interfere on any question that can be considered a political question, unless we are asked to express an opinion as to what the financial effect of a certain political operation may be. If we are asked, we give our advice, but we never seek to interfere in politics. The Treasury, on the other hand, are good enough to reciprocate ; that is to say, that, whilst we keep them fully informed as to the general trend of affairs in the City, as to any occurrences of importance affecting the position of finance and credit, they do not seek to dictate any alternative line of financial policy if we, in our judgment, consider a particular line of policy essential for the protection of the country’s main reserves. Apart from these visits that I have spoken of, it is the practice for the Governor to visit the Chancellor of the Exchequer at fairly frequent intervals, and to keep him also fully informed. And I suppose I need hardly say that the colour of the Government of the moment has absolutely no influence whatever on the nature of these relations.” He concluded by saying that “The Bank acts, of course, as the financial adviser of the Chancellor of the Exchequer. It does not seek to impose unsought advice, but, as I have already explained, its advice is always freely and fully at his disposal and, at the same time, it is able to act on occasions as a mouthpiece of the Chancellor to the City.”¹

A central bank is a public trust and not a department of State. It is for this reason that there should be no State interference with the ordinary working of the bank. If a Government had a controlling influence there are many ways by which the powerful interests in a country may try to enforce their wishes.

¹ Minutes of Evidence taken before the Committee on Finance and Industry, 1931, vol. i. Q. 454, pp. 31-2.

We have in the Bank of France between 1923 and 1925 the influence of extraneous forces on banking policy. Between 1923 and 1925 the Bank exceeded the legal limit of the note issue. In 1925 the volume of notes was 43 milliards although the maximum fixed by law in 1920 was 41 milliards. The balance-sheets actually hid this fact owing to Government compulsion, and the increased borrowings from the Bank intensified without any shadow of doubt the depreciation of the franc, and it was one of the causes leading up to the financial crisis of 1926. Excessive governmental influence must be sedulously avoided since otherwise reserve bank questions may at any moment become first-class political issues, and when politics come in at the door central banking is apt to fly out at the window. Governments, for example, must repay any advance within a fixed period, usually three months. Other central banks such as those of Germany, Czechoslovakia, Greece, and Bulgaria are limited not only in regard to time but also in the amount that can be lent to Government. The Bank of International Settlements, as described below, is similarly under its statutes prohibited from making advances to governments or opening current accounts in the name of governments. Therefore, all things considered, a central bank must be independent. One method of achieving this is that the capital in the very large majority of cases should be owned by shareholders and not by the State. Of thirty-two central banks no less than twenty-four are shareholders' banks, the capital being subscribed by private shareholders. This preserves the principle of freedom from Government control. In one or two instances, as in Australia, New Zealand, Russia, Sweden, Finland, Latvia, and Bulgaria, the banks are State-owned, and in the banks of Czechoslovakia and Colombia the Governments have subscribed part of its capital, but in the case of Colombia it has no voting power. Of the State central banks the Commonwealth Bank of Australia was, however, not a true central bank as it was still in competition with other banks in Australia and it had not either their support or goodwill. It was not a true bankers' bank, nor had it the control of currency to the degree that most other central banks possess. At first the Bank had no capital, but it had an understanding with the Government that the Government balances would not fall below a minimum, and this was in reality

the capital of the Bank.¹ It has now completed its transition from a commercial to a central bank. The state Bank of Russia is part of a Government department, the Ministry of Finance, subject to the direct authority of the Commissary of Finance, who determines the Bank's policy and fixes its rates of interest and commission. A bank such as this could hardly exist outside the Soviet Republic. The capital of the Riksbank of Sweden is owned by the Riksdag. The Bank, however, is not under an Executive Department of the Government but is responsible to the Riksdag, its Parliamentary Committee on Banking, and its Auditors. Sweden is a small united country with a high degree of education, and, owing to the innate genius of its people, the Riksdag has never used its powers. When a central bank works with a State capital it loses its independence, and the Governor of the Bank of England, in his evidence before the Royal Commission on Indian Currency and Finance, stated only a principle which is of almost universal application when he said that "We have the experience in Europe that in the case of the banks in which the Government held considerable measure of control, or there has been a limitation on the freedom of the Bank, it has not resulted to the advantage of the community".²

Even in countries where the capital of the bank is held by the State, steps have had to be taken in certain circumstances to render its administration independent of political influences and of the government. There is still a tendency in some quarters to the view that all banks should be nationalised, forgetting that were business to follow the example of banks the best man would tend

¹ Cf the New Zealand Reserve Bank Amendment Act, 1936, under which the State purchased the private share capital and the directors were to be appointed by the Governor-General in Council. The general functions of the Reserve Bank were restated as "to give effect, as far as may be, to the monetary policy of the Government as communicated from time to time by the Minister of Finance." The Minister of Finance stated in the House of Representatives that the Governor of the Reserve Bank was not in agreement in general with the principles of the Bill, but after making his protest against the principle had helped to put the Bill into words that would make it workable. It was passed by the House of Representatives on April 6 and by the Legislative Council on April 8. In the return made up on April 13 the share capital was omitted and the general reserve fund was given at £1,500,000 in place of £500,000 paid up capital and £1,000,000 as reserve, hitherto shown. This is a movement in a direction opposite to that of Australia. The aim of the Commonwealth of Australia has been to put currency policy outside the vagaries of party politics.

² Minutes of Evidence taken in London before the Royal Commission on Indian Currency and Finance, 1926, vol. v. Q. 14,605, p. 235.

to get to the top. The evils of the old private business have largely been eliminated in banking. Banks are in reality already nationalised, and do not exist for high dividends but in the public interest. A State system of banking would bring with it the dangers inherent in any monopoly, especially a monopoly controlled by the Government of the day. Banks have to deal with clients who may be old customers, and they are in a position to know their customers in a way that a State monopolist or a Minister sitting at the headquarters of a Government and realising that a general election is imminent would not be able to know or to assist. Sometimes, for instance, a wave of speculation takes place in stocks and shares and a central bank has to check such a movement carried on with borrowed money in order to avoid a crash. But where banking is a State monopoly and where a Government is contemplating some new issues or a conversion scheme, such action might not be taken by a Government bank. There are very great dangers in the nationalisation of a central bank.¹ Although in most cases the Government has certain powers in regard to the appointment of the Governor and other directors² of the bank, this in no way gives the Government

¹ What has been said above regarding a State-controlled central bank applies with even greater force to commercial banks. The dangers of State-controlled banking are considerable. A banking monopoly could not be expected to show the responsiveness to individual needs which is so essential to good banking. While no advantage is to be secured by the nationalisation of the banking system, this does not mean that the banking organisation of any country is incapable of improvement. Banks are the servants of trade and industry and must adapt themselves to the needs of their masters. It goes almost without saying that trade borrowers are likely to be better and more economically served by a few highly competitive institutions than by a vast nationalised commercial bank.

² Under the Federal Reserve Act, for example, three out of nine directors in each federal reserve bank are appointed by the Government, and the Board of Governors, all of whom are appointed by the Government, have the power, as stated in the text, to veto and reduce salaries and appointments in the several banks. In the Reserve Bank of India the Governor, two Deputy-Governors, four directors, and one Government official are appointed to the Board by Government, while eight directors are elected on behalf of the shareholders. The Bank of England as a central bank dates from 1844. The Charter leaves the Bank a very free hand, and a Supplemental Charter granted in 1892 deals only with matters of internal routine. The Charters define how often the Court of Directors is to sit, the appointment of Committees, how the cash is to be held, and similar matters. The Governor, the Deputy-Governor, and the twenty-four directors are not nominated by the Government but by the shareholders. The Bank of England, however, is a central bank *sui generis*. It is almost unique in that it is a private institution without any legal control except in regard to the granting of loans to the State and in regard to its powers of issuing bank notes.

power of interference in the administration of the bank. It is merely to ensure that the reserve bank will be in capable hands. No room must be left for doubt as to the ability of the bank to maintain its financial stability and credit at home and abroad. This is of great importance in the sphere of currency and exchange, which has an influence on the whole economic structure of the country and, therefore, has a far-reaching effect upon Government finances.

It is sometimes forgotten that a central bank (or to use the fuller term, "central reserve" bank) plays a most important part in public finance and, therefore, the Government must see that it is under sound management. It is a port to which recourse may be had in times of storm, or it may be said to be the fire brigade which puts out financial conflagrations. But this is far from saying that it should function only intermittently. Before the War such a bank existed in many countries. It is only after the War that the necessity of a central bank in every country of any importance became universally recognised as essential in financial administration. The Brussels International Financial Conference of 1920 recommended that "Where there is no central Bank of Issue, one should be established", and the Genoa International Financial Conference of 1922 brought this again into prominence by declaring that "Banks, and especially banks of issue, should be free from political pressure, and should be conducted solely on lines of prudent finance. In countries where there is no central bank of issue, one should be established." A central bank must not only be the Government banker but also the bankers' banker, *i.e.* it must control issues and the central reserves. Its primary duty is to the country and not to the shareholders. To achieve this end it must be able to control the credit situation without fetters or bias, and this can only be the case if it is not involved in it. It must not be placed in a position in which any doubt can arise as to its financial stability, and it must, therefore, never be exposed to the same risks to which commercial banks are generally exposed. Its business is not to make profits over what is required to pay a moderate limited dividend on the capital employed in it, and it must not be a burden on the taxpayer. Since the central bank transacts business rather for the sake of ulterior effects upon the banking structure than for making profit, it is usual to limit the dividends

to a maximum sufficient to remunerate capital, usually of the order of about 5 per cent per annum. This is fixed usually in consideration of two things : (1) the yield of Government long-term securities and (2) the necessity in some cases of attracting the small investor and thus securing a wide distribution of the shares of the bank. Any surplus above this amount, after the reserve equals the paid-up capital, the Government as a rule obtains or shares with the bank. The bank is in a very privileged position as the Government banker and the bankers' banker. It has an exclusive right of note issue ; it has the use of Government balances ; and it is able to compete on rare occasions when necessary by open-market operations with the commercial banks in order to control the credit situation. The bank should be prohibited from engaging in trade or otherwise having a direct interest in any commercial, industrial, or other undertaking ;¹ purchasing its own shares or the shares of any other bank or of any company or granting loans upon the security of any such shares ; advancing money on mortgage or otherwise on the security of immovable property or becoming the owner of immovable property except such as is necessary for its own business premises and residences for its officers and servants ; making unsecured loans and advances ; drawing or accepting bills payable otherwise than on demand ; and allowing interest on deposits or current accounts. A central bank in order to maintain the maximum fluidity of its assets may make advances against gold, the highest classes of Stock Exchange securities carrying a fixed rate of interest, commercial bills payable in the home market, foreign currencies, and bills payable abroad.

The chief functions of a central bank are to act as a note-issuing authority, to control credit in the country's interest, and to maintain the stability of the currency, which is the very foundation of all contractual relations. At first sight it may be thought that such important functions should be undertaken only by Government, but experience has shown that this cannot be done with advantage, since a central bank with expert knowledge and experience is able to conduct the country's note issue in a way that no Government department could do with similar efficiency. Moreover, there is another vital reason why the

¹ The only real prohibition in this regard in the case of the Bank of England is the prohibition for all time from using any of its funds in dealing in merchandise or wares of any description (Tonnage Act of 1694).

Government itself should not be entrusted with the note issue. It may have recourse to the printing press with most undesirable results, as the history of assignats and greenbacks proves. It is for these reasons that in financial administration a central bank is so important. By the issue of legal tender notes a central bank can supply or create ultimate reserve funds, and these notes can be used by other banks as reserves. Member banks are required to maintain reserve balances with the central bank which are the results of either cash deposits or paper re-discount.¹ The central bank can re-discount paper normally endorsed by other banks, and the proceeds are then issued in the form of its own funds or by credits to other member banks. The two fundamental problems, therefore, are the note-issue policy—the total amount of notes to be issued—and the discount policy. The discounting of member banks' paper is of the highest importance, especially in a country like India where there are indigenous bankers who can be linked up to the banking system by the discounting of their paper. By its open-market transactions this sphere of a central bank's influence has greatly been enlarged in recent years. The bank, when it is considered necessary for the purpose of regulating credit in the interest of commerce, industry, and agriculture, can purchase or sell securities or it may alter the types of securities so held with alteration in their total amount. If the Bank of England, for example, purchases securities in the market, the transaction is settled by crediting the drawing account of the broker or other party through whom it purchased the securities. This in turn leads to an increase in the balances of joint-stock banks at the Bank of England. The deposits of the joint-stock banks at the Bank are the equivalent of cash, and the banks are thus in a position to grant further loans to their customers or to create additional credit. In fact the Bank's action makes it possible for the joint-stock banks to increase their

¹ The Bank of England, the Bank of France, and several other European banks do not fix the amount to be left at the central bank. In the Federal Reserve system, the South African Reserve Bank, the Reserve Bank of India, and similar banks the percentage of the demand liabilities and of the time liabilities has been fixed. Under section 42 (1), for example, of the Indian Act every scheduled bank must maintain with the Reserve Bank a balance the amount of which at the close of business on any day shall not be less than 5 per cent of the demand liabilities and 2 per cent of the time liabilities. The liabilities do not include the paid-up capital or the reserve or any credit balance in the profit-and-loss account or the amount of any loan taken from the Reserve Bank.

deposits by some ten times, since the banks as a whole maintain a cash proportion to deposits of from 10 to 11 per cent. If, on the other hand, the Bank of England sells securities or calls in loans, this reduces the cash of the joint-stock banks and results in a reduction of their deposits. The bankers' cash may be increased by gold imports without any action on the part of the Bank of England. The Bank may offset these movements of gold in order to prevent expansion in deposits which might thus arise. The chief means of managing the monetary system of a country may be illustrated from the day-to-day policy of the Bank of England, which has four chief ways of managing the monetary system. In the first place there is the official bank-rate. This is the usual method of control. There are others, of which perhaps the chief are open-market transactions, technical devices for influencing the foreign exchanges, and the use of the Bank's personal influence over prominent elements in the London money market. The open-market transactions are of two kinds : those which have the effect of changing the aggregate amount of the Bank's private deposits, and those which consist of changing the form of the Bank's assets without changing their quantity. In regard to the former, the Bank may sometimes deliberately refrain from open-market transactions, and this may also have the effect of changing the total amount of the Bank's private deposits. Of the latter class of open-market operations, viz. those which do not change the quantity but only the form of the Bank's assets, may be mentioned the offsetting of gold movements by buying or selling securities, the selling of short-dated securities such as Treasury bills and the buying of long-dated securities such as Consols, or the forcing of the market to discount or to obtain advances on the official terms with the object of bringing the market rate into closer conformity with these by selling securities. In regard to technical devices these have increased with the growth in the technique of central banking by the Bank of England, which has advisers including ex-Treasury officials with special knowledge, especially of the exchanges and the working of foreign central banks. The Bank uses gold exchange methods, *i.e.* the selling or purchasing of foreign balances ; dealings in forward exchange ; and varying their buying price in a small degree for gold in order to influence directly the foreign exchanges. With these powers, which have

developed in recent years, the Bank has become a central bank with a strong control over the money market. Indeed it recalls the description of the Bank in *The Wealth of Nations* when Adam Smith affirms that "the stability of the Bank of England is equal to that of the British Government".

There are difficulties which central banks have to face, difficulties which are specially great in a country where commercial banks possess separate note issues. These difficulties may be grouped under three heads. Firstly, non-monetary causes of disturbance, such as political troubles, over-production, changes in tariffs, changes in demand following changes in fashion, rigidity of wages, and other internal economic conditions. A second group of causes is the divergency that sometimes occurs between the interests of the country itself and those of the world outside, as, for example, in 1930 when it was not in France's interest to attract gold from abroad in excess of what the Bank of France required, because this would have caused an unwanted expansion of credit within France and would have injured the French export trade by lowering foreign prices relatively to French prices and thus contracting the demand. The influx of the short-term foreign balances in the London money market is always to be regarded as the equivalent to a negative gold reserve, and is in consequence a potential source of future weakness. A third group of causes centres round inadequate control over the monetary machine. The Bank of England, for example, has got, as already noted, a remarkably complete system of control, but neither the Bank of France nor the Reichsbank nor even the Federal Reserve authorities have a control to the same extent.

There is thus much for a central bank to do, because, as is often said, the management of currency and credit is not a science but an art. The control of prices, however, is an enormously difficult matter. It necessitates the elimination of cyclical variations in the short-period and the elimination of changes in the long-period price-level. This aspect of central-bank policy, the possibility of exerting credit control in order to stabilise the price-level, came into prominence only after the World War. It is only possible if the bank has the power of directing and regulating the amount and use of bank credit in general, and if bank credit is the most important price-determining factor. The control of a central bank is difficult in countries where a bill

market is not developed, and where commercial banks are not willing to make use of the credit facilities available. Examples are the South African Reserve Bank and the Bank of Japan. A policy of patience, therefore, in this regard is essential. Advocates of price stabilisation through credit control point out that the central bank, by controlling the volume and velocity of currency, can regulate the price-level. Central banks have become more and more responsible for controlling price trends, and can neutralise the effect on prices of a large supply of new gold by increasing their own reserves, or they may counteract the effect of a fall in the output of gold by reducing the customary reserve ratios. But there are factors such as better methods of distribution and labour-saving devices that may operate on the goods side of the equation. Statistical information is also scanty. These are but a few of the factors against the theory. Governor Strong of the New York Federal Reserve Bank told the Stabilisation Committee of Congress in 1926 that there was no magic formula that could be introduced into the Federal Reserve Act for controlling prices. "I have", he said, "discussed these matters with many economists and students of prices and purposely have always carried the discussion through the same course. We have agreed on the record of the past in the Federal Reserve system pretty generally, as to what has been done and the effect of what has been done. We have generally agreed as to the conditions at the present moment. . . . But, when I ask them, 'Now, we have got to decide something to-day; you are in the position of running in the Federal Reserve system; what are you going to do to-day that will have an influence on the future?' the answer is always the same: 'Well, you are the practical fellows who are running this; you have got to decide that'. And that is the difficulty. Our examination of the past produces the most accurate knowledge of past action and reaction, but when it comes to a decision as to what we are going to do for the future, then just human judgment has got to govern. There is no mathematical formula for the administration of the Federal Reserve system or the regulation of prices."

The absence of a central bank means decentralised reserves, and this decentralisation is expensive and, at the same time, in times of crisis ineffective, because each bank then holds on to its cash balances and this intensifies the crisis. In the absence

of co-operation each bank has to hold a larger reserve than under a centralised system. The whole point of central banking in financial administration to-day rests on the principle that monetary stability can only be attained with efficiency and economy if the control of both currency and credit is placed in the charge of a single authority. Commercial banking cannot progress at a greater rate than that at which confidence proceeds in regard to the soundness of banks, and security depends upon the possibility of these being able in times of stress to turn into cash the maximum of their assets. Stringency breeds distrust, and distrust, as we have seen, leads to clinging to cash, and hence a crisis becomes inevitable. It is clear, then, that the development of joint-stock banking can only proceed safely under the shelter of a true central bank. Under a centralised system reserves can be replenished by re-discounting at the central bank, and since the demands for legal tender are at a single point, the ebb and flow of currency and credit can be supervised by the central bank itself.¹ In other words, the central bank possesses the power of changing the supply of cash and indefinitely expanding credit among the competitive banks, a power which it uses with caution. By adjusting bank rate and when necessary making it effective, the central bank should be able to dominate absolutely the credit market.

The monetary system of most, if not all, countries must be a managed system. The maintenance of the parity of the foreign exchanges without unnecessary disturbances to internal business, the avoidance as far as possible of the credit cycle, and the stability of the price-level are objectives of a sound monetary policy which require day in and day out knowledge, judgment, and authority which a central bank alone in its independent position with its great resources and technical devices can attain. The Macmillan Committee described the Bank of England in regard to this very point thus : " We have in the Bank of England an excellent instrument for the purpose ; independent of political influences, yet functioning solely in the public interest ;

¹ The Dominions and India are primary producers, which means that there is a strong seasonal ebb and flow of credit, and the creation of apex or central banks will tend to prevent large variations in credit throughout the year. It may be noted that where there are new and relatively undeveloped money markets, Treasury bills are a useful outlet for short-term funds, although this system with the absence of limitations of time and amount may be open to abuse.

with long traditions and experience and clothed with vast prestige, yet not distrustful (as we have learnt in evidence) of evolutionary change or hesitant of new responsibilities ; entrenched in the centre of the struggle for profit and with access to the arcana of the market, yet itself aloof and untinged by the motives of private gain".¹ In the realm of financial administration the central bank, therefore, has important functions to perform. It must have, in short, the right to note issue, the right to hold the reserves of commercial or member banks, the right to buy and sell securities, and the right to discount. It must be at all times able to meet the demands which may be made upon it—it must be able to guard its cash reserve when required.

We have discussed the importance in financial administration of a central bank in each country. It should be remembered that before the War there were isolated instances in times of crisis of international transfers of gold and inter-bank re-discounting. During the War there was pooling of resources by central banks both among Allies and the Central Powers, and when the United States entered the War in 1917 the Federal Reserve system's resources were also thrown into the common pool. In 1930 a world central bank, called the Bank of International Settlements, was organised under a Swiss Government Charter by representatives of Belgium, England, France, Germany, Italy, Japan, and an American banking group. It was born out of the Young Plan, and the first ideas of which came from Genoa, when it was proposed that the Bank of England should summon a conference of all central banks to do what the Bank of International Settlements was subsequently asked to do. The object was to bring about international co-operation among central banks and to try to bring about a common policy between them. Article 3 of the Statutes expresses this idea thus : " La Banque a pour objet : de favoriser la coopération des banques centrales et de fournir des facilités additionnelles pour les opérations financières internationales ; et d'agir comme mandataire (trustee) ou comme agent en ce qui concerne les règlements financiers internationaux qui lui sont confiés en vertu d'accords passés avec les parties intéressées ".² The particular object of the creation of the Bank

¹ Report of the Committee on Finance and Industry (Macmillan Report). Cmd. 3897, 1931, p. 119, para. 281.

² *Banque des Règlements Internationaux, Charte et Statuts, Fait à La Haye, le 20 Janvier 1930*, ch. i. article 3.

was to get rid of the difficulty of reparations payments, to take them out of the political arena and to put them, in the words of the Governor of the Bank of England, "into a back room in the B.I.S.". With reparations payments now discontinued, international debt questions were linked up. The Bank of International Settlements has provided a method of conference among central banks, and has allowed many who are interested in the art of central banking to meet regularly once a month to discuss all matters of the individual central banks as well as those of the Bank of International Settlements. Since 1931 a large number of the European central banks have been keeping their surplus reserves with the Bank of International Settlements, but those funds being reserves are not free for general use, and they can only be employed within the same strict limitations as in the case of the central banks themselves. In short, the Bank of International Settlements never can have very large sums which it can dispose of. With the passing of reparations its duties have become much less important, and it has now to go slowly and to develop by degrees. It has been able to arrange certain conveniences among the central banks in the transfer of funds from one place to another, but there are special difficulties of an international body of this sort. Mr. Norman, the Governor of the Bank of England, put these difficulties thus: "A Central Bank Governor, when he comes to Basle, is necessarily to a certain extent dominated by the particular state of his own fiscal and economic situation at home, of the mind of his public, of the mind of his Government, and it is a matter therefore, not, as I say again, of establishing personal friendship—which we have done to a marvellous degree, I think, almost intimately—but of taking up questions which are international and regarding them, as one would say, on their merits. No two or three countries can really regard an international question on its merits. There is no such thing as merits when you come to that. To get the affairs of a country, and possibly the needs of a country, considered on their merits is a thing which has not been achieved, and, I believe, will not be achieved for a very long time. The moment the position of certain countries is mentioned you get a reaction for or against, for particular reasons applicable to the individual in whom the reaction takes place. There will be a new Europe before we get away from that." The Bank of

International Settlements is not allowed under Article 25 to exercise the power of note issue, to make advances to Governments, or to open current accounts in the name of Governments, and it must, on account of its position at Basle, encounter difficulties as a bank of deposit, especially as it is situated far apart from its chief customers. Nevertheless it marks a distinct advance in the idea of a world central bank, and in the future it may exercise some degree of control in the various countries upon credit and exchange rates. Provision may be made in the future to regard balances with the Bank of International Settlements as the equivalent of gold. It would be a beginning of international economy in the use of gold in international banking practice. The influence of the Bank of International Settlements will, in years to come, be rather in the field of international currency and banking than that of public finance. Its indirect influences, however, through these common consultations, may be not inconsiderable in that important branch of Public Finance —financial administration.

APPENDIX

TABLE I.—THE RELATIVE FINANCIAL POSITION OF THE CHIEF COUNTRIES OF THE WORLD, 1933-34

Countries.	Area (Sq. Miles).	Population (000).	Revenue (million £).	Expendi- ture (million £).	National Income (million £).	Per Capita.			
						Debt £)	Revenue (£)	Expendi- ture (£)	National Income (£)
The British Empire—									
United Kingdom	94,633	46,356 ¹	809	778	3,500 ⁷	8030	17.5	16.8	173.4
British India	1,318,346*	273,614†	166	170	1,203 ⁸	920	0.6	0.6	3.4
Other Dominions—									
Australia	2,974,581	6,677 ¹	74	70	1,219 ¹⁰	645	11.1	10.5	183.2
Canada	5,729,665	10,377 ¹	68	72	1,186 ¹¹	274	4.7	3.3	62.2
Union of South Africa	8,483 ¹	40	28						32.3
Other Countries—									
Austria	32,369	6,759 ⁴	37	42	193 ¹²	95	5.5	6.2	14.0
Belgium	11,775	8,248 ⁵	59	60	278 ¹⁰	325	7.2	7.3	39.3
Bulgaria	39,825	6,090 ⁴	8	8	54 ¹³	33	1.3	1.3	5.4
Chile	285,133	4,287 ³	24	24	137 ¹⁰	102	5.5	5.5	23.8
Czechoslovakia	54,244	14,730 ³	53	53	506 ¹⁴	227	3.6	3.6	15.4
Denmark	16,576	3,656 ¹	21	22	192 ¹²	73	5.7	6.0	20.0
France	212,659	41,835 ²	367	406	1,693 ¹⁰	257.4	8.8	9.7	41.6
Germany	181,699	66,044 ⁶	228	301	2,448 ¹³	673	3.4	4.6	39.0
Greece	50,270	6,620 ⁵	26	28	125 ¹²	115	3.9	4.2	20.2
Hungary	36,180	8,068 ³	39	42	165 ¹⁰	58	4.5	4.8	6.7
Italy	11,9713	42,217 ¹	176	225	972 ¹²	1016	4.2	5.3	26.6
Japan	147,593	68,195 ¹	235	230	1,132 ¹⁴	887	3.4	3.4	13.0
Latvia	10,435	1,900 ³	..	..	36 ¹⁴	42	..	..	22.1
Netherlands	112,579	8,291 ⁵	5	..	434 ¹⁴	281	7.0	6.2	33.9
Norway	121,556	2,814 ³	20	17	145 ¹²	85	5.2	5.2	30.2
Poland	149,274	31,948 ²	44	50	462 ¹⁰	99	1.4	1.6	3.1
Spain	196,607	24,242 ⁵	19	19	847 ¹³	854	0.8	0.8	35.2
Sweden	173,347	6,512 ⁵	58	59	327 ¹⁶	120	9.3	9.4	20.8
Switzerland	15,940	4,066 ³	16	19	321 ¹⁶	86	4.0	4.7	21.2
United States of America	2,913,776	122,775 ³	1,250	1,090	10,556 ¹³	5358	10.2	8.9	43.6
U.S.S.R. (Russia)	8,241,921	165,778 ⁵	..	..	1,461 ¹⁴	1068	..	..	6.4

* India, including Indian States, 1,808,679.

† 1933. India, including Indian States, 370,000,000 (Public Health Commissioner, Government of India, 1935).

‡ The currencies of various countries have been converted at the par rate of exchange.

§ 1931 Census.

* 1930 Census.

** 1927-28.

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** 1933 Census.

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REVENUE, EXPENDITURE, AND DEBT OF THE GOVERNMENTS IN INDIA (CENTRAL AND PROVINCIAL)

(Years represent years ended 30th April till 1866 and 31st March from 1867 onwards.)

1072

THE SCIENCE OF PUBLIC FINANCE

Year.	Finance Member.	Revenue.		Expenditure.		Surplus. Lakhs of Rs.	Deficit Lakhs of Rs.	Public Debt Lakhs of Rs.	Per Head of Population.		Equivalent of Debt in Terms of Revenue.
		Lakhs of Rs.	Lakhs of Rs.	Revenue.	Expendi- ture Lakhs of Rs.				Revenue	Expendi- ture. Rs.	
1845	"	23.67	24.29	..	..	62	43.50	1.63	1.70	3.01	1.84
1846	"	24.27	25.66	..	..	1.39	43.89	1.70	1.80	3.03	1.81
1847	"	25.08	26.92	..	..	84	46.88	1.80	1.90	3.24	1.80
1848	"	24.91	26.75	..	..	1.84	48.76	1.72	1.80	3.37	1.96
1849	"	25.40	26.77	..	..	1.27	51.06	1.80	1.90	3.53	2.01
1850	"	27.32	26.96	.56	..	53.93	1.90	1.90	3.73	1.96	
1851	"	27.63	27.00	63	..	55.10	1.91	1.87	3.81	1.98	
1852	"	27.83	27.10	73	..	55.11	1.92	1.87	3.81	1.98	
1853	"	28.61	27.98	63	..	56.23	1.98	1.93	3.89	1.97	
1854	"	28.28	30.24	..	..	53.68	1.95	2.09	3.71	1.90	
1855	"	29.15	30.75	..	..	55.53	2.01	2.13	3.84	1.91	
1856	"	30.92	31.64	..	..	57.76	1.98	2.04	3.72	1.87	
1857	"	31.69	31.61	8	..	57.92	1.98	2.03	3.83	1.88	
1858	"	31.71	41.24	..	..	63.46	2.04	2.05	4.47	2.19	
1859	The Rt. Hon. James Wilson	"	36.06	51.06	..	69.47	2.04	2.22	5.23	2.25	
1860	The Rt. Hon. Samuel Laing	"	39.71	51.86	..	81.17	2.04	2.22	5.29	2.47	
1861	"	42.90	48.15	..	..	12.15	98.11	2.56	3.34	6.32	2.37
1862	"	44.05	44.10	..	..	5.35	101.88	2.16	3.10	6.56	2.44
1863	Sir Charles Trevelyan, K.C.B.	"	45.33	43.50	1.83	..	107.51	2.84	2.80	6.92	2.31
1864	"	45.04	44.96	8	..	104.50	2.92	2.80	6.73	2.31	
1865	"	45.85	46.04	..	..	98.52	2.90	2.89	6.34	2.19	
1866	The Rt. Hon. W. N. Massey	"	49.07	46.31	276	19	98.48	2.95	2.96	6.34	2.15
1867	"	49.12	44.64	..	..	2.62	98.38	3.25	3.06	6.51	2.00
1868	"	48.53	50.14	..	..	1.61	101.99	2.79	2.95	6.75	2.42
1869	Sir Richard Temple, K.G.S.I.	"	49.26	53.41	..	4.15	102.87	3.21	3.32	6.75	2.10
1870	"	50.90	53.38	..	..	4.15	102.87	3.26	3.52	6.81	2.09
1871	"	51.41	51.10	..	..	2.48	108.19	3.37	3.53	7.16	2.13
1872	"	50.11	48.61	1.30	..	11.71	2.77	2.75	3.34	2.17	
1873	"	50.22	50.64	..	..	11.58	2.70	2.62	6.27	2.31	
1874	"	49.60	54.96	..	..	4.42	117.96	2.73	2.73	6.38	2.35
1875	"	50.57	54.50	..	..	5.36	124.22	2.67	2.96	6.56	2.44
1876	Sir John Strachey, K.C.S.I., C.I.E.	"	60.43	58.77	1.06	3.93	127.95	2.73	2.94	6.92	2.63
1877	Sir John Strachey, K.C.S.I., C.I.E.	"	58.75	60.93	..	6.18	134.17	2.94	2.96	7.26	2.22
1878	"	62.92	65.56	..	..	3.64	136.60	2.96	2.07	7.38	2.33
1879	"	65.19	63.06	2.13	..	11.58	142.95	3.12	3.30	7.74	2.30
1880	Lord Cromer, C.S.I., C.I.E. (Major Evelyn Barneby)	"	68.43	69.66	..	1.23	145.91	3.28	3.17	7.34	2.24
1881	"	74.29	77.92	..	..	100.37	160.37	3.44	3.50	8.07	2.34
1882	"	75.68	72.09	3.59	..	3.63	167.21	3.74	3.92	8.42	2.25
1883	Sir Auckland Colvin, K.C.M.G., C.I.E.	"	70.25	69.60	68	..	166.92	3.81	3.63	8.40	2.21
1884	"	71.84	69.96	1.88	..	169.24	3.94	3.50	8.52	2.21	
1885	"	70.69	71.03	..	..	171.61	3.61	3.52	8.64	2.39	
1886	"	74.46	77.27	..	..	173.72	3.56	3.58	8.75	2.46	
1887	"	75.34	77.16	18	..	174.53	3.57	3.49	8.80	2.34	
1888	Sir James Westland, K.C.S.I.	"	78.76	80.79	..	185.67	3.50	3.49	8.89	2.40	
1889	Sir David Barbour, K.C.S.I.	"	81.70	81.66	4	2.03	191.95	3.56	3.65	8.98	2.44
1890	"	85.09	82.47	..	..	206.62	3.69	3.69	9.04	2.53	
				85.09	211.63	..	211.63	3.85	3.73	9.57	

THEORY OF THE EARTH

¹ For eleven months only. The official year was changed from 30th April to 31st March.
² From this year, the working expenses of railways are treated as a deduction from the revenue as expenditure and not as expenditure.

SOURCE.—Finance and Revenue Accounts of the Government of India, Government of India Press, New Delhi.

TABLE II.—(continued)

By the Reforms introduced in 1921–22, Budgets of the Central and Provincial Governments are separated, hence it is preferable to give separate data for them.

Year.	Revenue.		Expenditure.		Per Head of Population.		
	Central. (Lakhs of Rs.)	Provincial. (Lakhs of Rs.)	Central. (Lakhs of Rs.)	Provincial. (Lakhs of Rs.)	Central. Rs.	Provincial. Rs.	Central. Rs.
1922	128.33	74.43	155.98	83.16	5.20	3.01	6.34
1923	136.73	79.46	151.74	80.96	5.53	3.22	6.14
1924*	145.27	82.69	142.88	79.93	5.87	3.36	5.79
1925	151.70	85.45	146.02	82.57	6.14	3.46	5.91
1926	145.62	92.03	141.31	91.41	5.89	3.73	5.72
1927	144.56	91.18	144.56	94.92	5.85	3.69	5.85
1928	140.78	98.49	140.78	96.70	5.70	3.99	5.70
1929	142.98	96.91	143.30	98.33	5.79	3.92	5.80
1930	147.03	100.73	146.76	99.96	5.95	4.08	5.94
1931	138.97	89.02	150.56	100.19	5.63	3.40	6.10
1932	135.46	87.97	147.21	91.49	4.99	3.24	5.42
1933	139.78	88.49	137.27	90.77	5.15	3.26	5.06
1934	133.24	88.04	133.24	91.09	4.91	3.24	4.91

TABLE III

Gross Expenditure of the Governments in India, Central and Provincial, from the fiscal year 1861-62, classified under main heads of expenditure.

TABLE
CLASSIFICATION OF
GROSS EXPENDITURE OF THE GOVERNMENTS IN INDIA (CENTRAL
(In Thousands)

Heads of Expenditure.	1861-62.	1871-72.	1881-82.	1891-92.	1901-02	1911-12.
<i>A. Primary Expenditure.</i>						
I Defence . . .	16,94,96 38·4	16,25,22 33·4	20,35,27 28·2	23,51,34 26·5	25,83,37 28·9	31,35,25 26·5
II. Law and order—						
Law and justice . . .	1,89,99	2,91,48	3,23,28	3,73,97	4,30,39	5,73,71
Police . . .	2,14,91	2,22,09	2,55,39	3,86,86	4,03,70	6,90,45
Total . . .	4,04,90 9·2	5,13,57 10·6	5,78,67 8·0	7,60,83 8·6	8,43,09 9·4	12,64,16 10·7
III. Civil administration—						
General administration . . .	1,48,42	1,82,71	1,54,21	1,79,13	1,93,59	3,93,94
Political . . .	24,20	31,54	65,47	76,77	1,03,06	1,45,22
Cost of collection—						
Direct taxes . . .	1,83,36	2,46,70	3,08,73	3,92,34	4,29,36	5,72,21
Indirect taxes . . .	2,42,90	2,50,06	3,11,55	2,99,36	3,83,63	3,23,41
Total . . .	5,98,88	7,11,01	8,39,96	9,47,60	11,09,34	14,34,78
13·6	14·6	11·7	10·7	12·4	12·5	12·1
IV. Debt services—						
Productive purposes . . .	1,42,51	1,72,32	1,88,68	5,78,36	8,24,36	11,77,06
Unproductive purposes . . .	5,19,10	5,96,63	4,85,94	4,81,52	2,91,61	3,05,66
Total . . .	6,61,61	7,68,95	6,74,62	10,09,88	11,15,97	14,82,72
15·0	15·8	9·4	11·4	12·5	12·5	12·3
Total of A as percentage .	76·2	74·4	57·3	57·2	63·2	61·8
<i>B. Secondary Expenditure.</i>						
V. Social—						
Education . . .	34,30	68,34	1,07,86	1,42,48	1,07,10	3,03,18
Medical and sanitation . . .	23,55	50,05	68,47	88,47	91,45	1,73,32
Famine relief, etc. . .	.	.	1,56,79	1,26,83	1,32,61	1,50,00
Ecclesiastical . . .	14,89	15,80	16,22	16,16	16,91	18,67
Total . . .	72,74	1,29,19	3,49,34	3,73,94	3,48,07	6,45,17
1·6	2·7	4·8	4·2	3·9	5·4	
VI. Government or public undertakings—						
Railways . . .	..	..	10,52,33	15,74,32	7,99,41	8,15,96
Irrigation . . .	..	..	1,32,20	1,83,53	2,12,67	2,98,80
Other public works . . .	4,75,50	4,21,86	5,04,79	6,20,88	3,81,46	8,18,11
Posts and telegraphs . . .	99,77	1,10,72	{ 1,80,45	2,42,92 }	3,22,34	4,65,36
Mint . . .	10,73	8,39	..	..	75,60	17,48
Stationery and printing . . .	17,03	11,61	59,04	60,29	80,08	1,00,45
Forests . . .	9,00	33,46	55,87	84,39	1,05,84	1,71,33
Ports and pilotage . . .	.	.	..	..	19,39	27,25
Scientific and miscellaneous . . .	.	.	56,52	58,74	71,51	1,44,18
Total . . .	6,12,03	5,88,04	20,41,20	28,25,07	20,68,30	28,58,92
13·9	12·1	28·3	31·8	23·1	24·2	
VII. Miscellaneous—						
Refunds, drawbacks, etc. . .	2,23,25	2,01,02	1,46,68	1,78,62	1,89,02	2,33,58
Miscellaneous . . .	1,41,46	3,24,74	5,42,22	4,20,28	6,94,61	7,79,73
Total . . .	3,64,71	5,25,76	6,89,90	5,98,90	8,83,63	10,13,31
8·3	10·8	9·6	6·8	9·8	8·6	
Total of B as percentage .	23·8	25·6	42·7	42·8	36·8	38·2
Grand total of expenditure	44,09,83 100·0	48,61,74 100·0	72,08,96 100·0	88,67,56 100·0	89,52,07 100·0	118,34,31 100·0

¹ Charges of District Executive Officers performing magisterial functions were before 1921-22

² The increase in 1921-22 is mostly due to the inclusion of district administration which prior to

³ In the "Finance and Revenue Accounts" of the Government of India the working expenses
tables, etc.) have been shown as deduction from revenue and not as expenditure. For comparative

⁴ Includes only "Refunds and Drawbacks". Assignments and compensation have been included

⁵ Includes superannuation and pension allowances, exchange, etc.

SOURCE.—*Finance and Revenue Accounts of the Government of India*, Government of India Press,

III

EXPENDITURE

AND PROVINCIAL) FROM THE FISCAL YEAR 1861-62, CLASSIFIED
of Rupees.)

Pre-War year. 1913-14	1919-20.	1921-22	1926-27.	1929-30.	1930-31.	1931-32	1932-33.	1933-34.
31,89,86 25-6	91,03,00 41-2	77,87,98 32-6	60,91,64 25-4	59,08,09 23-9	58,28,90 23-2	55,88,74 23-4	50,37,50 22-1	49,75,09 22-2
6,10,66 7,29,75 13,40,41 10-8	7,92,76 10,27,52 18,20,23 8-2	7,79,89 ¹ 12,84,03 20,63,92 8-6	8,32,30 12,38,06 20,70,36 8-7	8,78,84 9,01,98 13,56,61 8-9	8,17,22 13,44,12 21,86,67 9-0	7,72,50 12,89,05 21,61,34 9-0	7,77,71 12,90,81 20,68,52 9-2	
2,97,55 1,73,88	3,91,14 3,18,57	11,03,70 ² 2,25,62	13,62,62 3,31,92	14,95,06 4,31,25	15,15,73 4,73,57	14,67,14 4,03,34	13,54,84 3,63,04	12,94,32 3,51,66
6,02,65 3,75,78 14,49,86 11-7	6,59,90 6,53,48 18,06,89 8-2	6,20,86 6,42,24 26,03,66 10-9	4,84,63 5,96,57 28,23,41 11-8	4,98,75 6,07,52 30,21,63 12-2	4,92,66 5,63,60 30,89,48 12-3	4,74,72 5,72,55 29,08,80 12-2	4,31,35 4,27,18 27,21,78 [*] 11-9	5,75,71 26,48,87 11-8
12,91,20 2,27,35 15,18,55 12-2	15,49,40 13,40,85 28,90,25 13-0	18,95,09 17,01,06 35,97,05 15-0	29,19,56 19,66,12 48,85,68 20-4	35,61,13 19,38,54 54,99,67 22-3	33,56,64 20,17,07 58,78,71 23-5	39,06,12 23,03,40 62,09,52 26-0	39,27,81 22,29,22 61,57,03 27-0	39,18,75 16,06,09 55,19,84 24-5
60 3	70-6	67-1	66 3	67 3	68 0	70 6	70 0	67 7
4,76,52 2,00,89 1,50,00 19,16 8,46,37 6-8	6,86,02 3,21,97 1,71,01 20,17 11,99,17 5-4	9,00,24 4,73,13 1,33,73 30,50 15,37,60	12,10,45 5,97,82 1,08,65 32,50 19,49,42	13,58,76 6,91,95 39,28 31,63 21,11,62	13,79,43 6,39,11 35,11 32,15 20,85,80	12,82,63 5,81,85 29,61 30,27 19,24,36	11,82,30 5,34,82 9,63 28,72 17,55,47	12,04,62 5,46,10 4,67 29,32 17,86,71
8,29,95 3,34,05 10,51,51 4,90,95 19,90 1,09,46 1,76,17 30,69 1,51,23 31,93,91 25-7	9,47,76 4,06,24 10,69,81 7,13,44 1,91,44 2,15,72 4,21,69 51,71 3,78,79 40,14,97 18-2	9,03,39 6,23,75 ³ 12,60,91 10,07,69 ³ 10,39,41 ³ 21,57,72 3,73,42 46,37 3,93,69 45,96,11 20-8	3,71,11 ³ 7,32,95 ³ 14,16,59 10,39,41 ³ 1,07,48 1,45,70 3,69,63 45,50 4,84,97 46,84,37 19-2	1,93,47 6,91,70 14,85,58 11,63,72 70,37 1,73,60 3,60,63 41,80 5,76,75 46,60,68 19 0	2,06,23 6,48,56 13,90,35 11,71,10 74,20 1,76,80 3,52,13 41,80 5,76,75 46,60,68 18-6	1,86,02 4,35,19 11,38,34 10,27,41 96,96 1,65,88 2,08,54 25,71 4,80,28 37,43,46 15-7	1,80,19 4,67,48 9,29,45 10,19,29 76,09 1,35,74 2,09,85 33,16 4,80,77 36,02,60 15 8	1,74,44 4,96,93 9,24,14 10,43,64 65,67 1,29,57 3,26,62 26,00 4,89,32 36,69,97 16-4
2,36,59 6,58,67 8,95,26 7-2	4,21,15 8,58,18 12,79,33 5-8	4,50,28 ⁴ 9,02,87 ⁴ 13,53,15 5-6	3,07,29 ⁴ 12,25,94 ⁴ 15,33,23 6-4	3,25,24 9,34,86 12,60,10 5-1	3,15,67 9,61,75 12,77,42 5 1	3,48,10 9,85,99 13,34,09 5 6	3,76,44 10,91,32 14,67,76 6-5	3,94,73 13,69,40 17,64,13 7-9
39-7 124,34,22 100-0	29-4 221,13,89 100-0	32-9 239,14,49 100-0	33-7 239,47,85 100-0	32-7 246,72,15 100-0	32 0 250,74,58 100-0	29 4 238,70,31 100-0	30-0 228,03,69 100-0	32-3 224,33,13 100-0

distributed between "Land Revenue" and "Law and Justice".

1921-22 was directed between "Land Revenue" and "Law and Justice".

(principally incurred upon the upkeep of establishments, conveyance of mails, maintenance of lines and purposes these have been added to revenue as well as expenditure. in cost of collection.

TABLE IV
DISTRIBUTION OF PUBLIC EXPENDITURE IN INDIA AMONG CENTRAL, PROVINCIAL, AND LOCAL AUTHORITIES
(In Thousands of Rupees.)

1913-14.							1931-32			
Heads of Expenditure.			Central.	Provincial.	Local.	Total.	Central	Provincial	Local.	Total.
<i>A. Primary Expenditure.</i>										
I. Defence	.	Total	31,89,86	..	..	31,89,86	55,88,74	..	55,88,74
			41,0	..	..	21,3	38,0	19,2	19,2
II. Law and order—										
Law and justice	.	Total	5,73,54	..	..	5,73,54	7,62,27	8,17,22	8,17,22
Police	.	Total	6,38,03	52	52	7,30,27	12,53,08	13,44,84	13,44,84	
			12,72,57	52	52	13,40,93	20,18,35	21,62,06	21,62,06	
			0,9	..	..	9,0	1,0	7,2	7,4
III. Civil administration—										
General administration	.	Total	1,66,82	70,22	3,67,77	2,99,27	11,67,87	1,65,98	16,33,12	
Political	.	Total	1,37,65	36,23	1,73,88	4,03,34	..	..	4,03,34
Cost of collection—										
Direct taxes	.	Total	5,56,20	..	6,02,65	83,05	3,91,67	..	4,74,72	
Indirect taxes	.	Total	2,80,88	70,22	3,76,78	2,98,56	5,65,04	..	5,63,60	
			6,31,40	8,18,46	16,20,08	10,81,22	18,21,58	1,65,08	30,74,78	
			8,1	17,6	10,2	7,4	20,0	3,2	10,6	
IV. Debt services—										
Productive	.	Total	11,91,86	..	12,91,20	32,91,72	6,14,40	..	39,06,12	
Unproductive	.	Total	1,94,40	32,95	2,27,35	19,72,39	3,31,01	23,03,40	23,03,40	
			13,86,26	1,32,29	2,40,47	17,59,02	5,2,64,11	9,45,41	69,31,45	
			17,8	2,8	9,6	11,8	35,8	10,3	23,8	
Total primary expenditure	.	Total	52,76,36	22,23,32	3,11,21	78,09,89	120,80,06	47,88,34	177,57,03	
			67,8	47,8	12,4	52,3	82,2	52,4	16,9	

APPENDIX

1079

<i>B. Secondary Expenditure.</i>							
V. Social—							
Education	18.08	4,58,44	2,06,46	6,82,98	62,16	12,20,47	8,40,31
Medical and sanitation	20.78	1,79,91	3,50,17	5,50,86	47,09	5,3,76	7,68,32
Famine relief	1,12,50	37,50	..	1,50,00	18	29,43	13,50,17
Others	..	19,16	67,5,85	5,85,67	51,90	12,73	20,61
Total	2.2	1,70,52	14.5	14,35,04	9.6	1,39,70	35,43,00
VI. Government or public undertakings—							
Railways	..	8,29,57	38	..	8,29,95	17,84,66	16,21,36
Irrigation	..	1,39,55	1,94,50	..	1,86,01	12,73	30,9
Other public works	..	1,58,82	8,92,99	4,85,07	16,30,53	4,16,93	1,86,02
Posts and telegraphs	..	4,90,95	..	4,90,95	3,31,05	2,38,52	4,35,19
Mint	19.90	..	..	19,90	76,09	10,27,41	17,19,44
Stationery and printing	32.11	77,35	..	1,69,46	57,62	1,08,26	10,37,41
Forests	1,64,15	..	..	1,6,17	31,53	1,77,01	16,69
Ports and pilotage	11,42	30,66	..	30,69	22,29	3,42	1,69,88
Scientific departments	3	87,70	..	1,51,53	1,73,01	3,07,27	2,08,54
Others	63.53	..	17,45,88	1,74,87	1,7,4,57	2,97,13	35,71
Total	22.4	31.2	14,18,03	6,59,94	38,53,85	19,12,72	8,78,23
18.30,74	25.8	26.9	12.4	12.4	20.9	16.7	46,21,09
VII. Miscellaneous expenses—							
Refunds and drawbacks	..	1,16,25	1,20,34	2,36,59	2,91,35	56,75	3,38,10
Miscellaneous others	4,77,85	1,80,82	34,60	6,93,57	3,79,33	6,06,66	10,94,61
Investments, advances, and deposits	..	..	..	9,10,62	6,70,68	6,63,41	17,56,66
Total	..	6,94,10	3,01,16	9,45,22	4,3	7,2	31,99,37
Total secondary expenditure	..	25,10,50	24,25,04	21,93,83	71,29,37	26,41,12	43,64,87
Grand total	..	32.2	52.2	87.6	47.7	17.8	113,66,78
	100.0	100.0	100.0	100.0	100.0	100.0	39.0
							201,23,81
							100.0

SOURCE.—*Finance and Revenue Accounts of the Government of India*, Government of India Press, New Delhi, and *The Statistical Abstract for British India*.

TABLE V
DISTRIBUTION OF EXPENDITURE
DISTRIBUTION OF THE GROSS EXPENDITURE CHARGEABLE AGAINST THE
REVENUE OF INDIA (CENTRAL AND PROVINCIAL)

TABLE VI

INCREASE IN EXPENDITURE

INDEX NUMBERS OF GROSS EXPENDITURE OF THE GOVERNMENTS IN INDIA
(CENTRAL AND PROVINCIAL)

(Figures for 1871-72=100.)

(For details see Table III)

Heads of Expenditure	1871-72	1881-82	1891-92	1901-02	1911-12	Prec War Year 1913-14	1921-22	1926-27	1933-34
<i>A. Primary Expenditure</i>									
I. Defence . . .	100	125	145	159	193	196	479	375	306
II. Law and order— Law and justice Police . . .	100 100	111 115	128 174	151 182	197 311	210 329	268 578	285 558	266 581
Total . . .	100	113	148	164	246	261	402	403	403
III Civil administration— General administration Political Cost of collection— Direct Indirect . . .	100 100 100 100	84 208	98 243	106 327	216 460	163 551	604 715	744 1052	708 1115
Total . . .	100	118	133	156	202	204	366	397	373
IV. Debt services— Productive . . . Unproductive . . .	100 100	109 81	336 72	478 49	683 51	749 38	1099 285	1694 320	2271 269
Total . . .	100	88	131	145	193	197	468	638	718
<i>B. Secondary Expenditure.</i>									
V. Social— Education . . . Medical and sanitation . . . Famine . . . Ecclesiastical . . .	100 100 100 100	170 137 100 ¹ 103	225 177 81 102	169 183 85 107	479 346 96 118	752 401 96 121	1421 945 85 193	1911 1194 69 206	1902 1095 3 186
Total . . .	100	270	289	269	499	655	1190	1511	1383
VI. Public undertakings— Railways . . . Irrigation . . . Other public works . . . Posts and telegraphs . . . Mint . . . Stationery, etc. . . Forests . . . Ports and pilotage . . . Scientific and miscellaneous departments . . .	.. 100 ¹ 100 100 100 100 100 100 100 ¹	100 ¹ 139 120 151 204 901 291 420 237 104	150 161 147 151 901 298 443 497 127	76 226 90 208 91 865 443 1189 255	78 253 194 428 237 943 910 1189 1858	79 472 249 910 1281 943 910 1189 1255	86 554 335 937 910 85 69 1053 1116	35 376 219 943 707 821 921 1053 134	17 376 219 943 707 821 921 1053 134
Total . . .	100	347	480	352	486	543	845	751	624
VII Miscellaneous— Refunds, etc. . . Miscellaneous . . .	100 100	73 167	89 129	94 214	116 240	118 203	224 278	153 377	196 422
Total . . .	100	131	114	168	193	170	257	291	336
Grand total . . .	100	148	182	184	243	256	492	493	461

¹ In these cases figures for 1881-82 are taken as 100.² In this case figure for 1901-02 is taken as 100.

TABLE VII

PER CAPITA EXPENDITURE ALLOWING FOR PRICES CHANGES IN VARIOUS COUNTRIES¹

Fiscal Year. ²	United Kingdom	United States	France ³	Italy.	Germany.	Japan	India.
1902-03	8.3	4.6	4.9	2.9	9.1 ³	1.0	0.5
1912-13	8.2	6.8	6.3	4.5	13.8	1.8	0.4
1913-14	8.2	7.1	6.7	4.4	14.1	1.7	0.4
1914-15	15.7	7.5	11.8	6.5	17.3	1.9	0.4
1915-16	28.7	6.5	17.0	7.7	20.9	1.7	0.4
1916-17	30.6	6.8	20.5	8.8	21.3	1.5	0.4
1917-18	29.8	12.7	17.8	7.9	29.7	1.3	0.5
1918-19	26.8	18.0	17.3	9.5	23.3	1.3	0.5
1919-20	15.9	7.9	15.8	5.2	23.9	1.2	0.4
1920-21	12.4	9.2	12.0	5.2	11.5	1.6	0.4
1921-22	12.8	..	15.6	1.0	4.0	1.4	0.5
1922-23	9.8	12.2	15.9	1.3	..	1.3	0.5
1923-24	10.2	13.2	6.0	1.2	..	1.3	0.4
1924-25	9.7	12.2	6.7	1.1	5.0	1.4	0.4
1925-26	11.6	13.4	5.9	1.0	5.1	1.2	0.4
1926-27	12.6	13.2	5.2	1.0	5.4	1.4	0.5
1927-28	13.1	14.4	6.0	1.5	5.8	1.7	0.5
1928-29	12.7	14.7	6.4	1.2	6.6	1.7	0.5
1929-30	13.3	15.5	7.1	1.2	6.5	1.7	0.5
1930-31	16.1	17.7	9.0	1.7	7.4	1.8	0.6
1931-32	17.7	22.3	9.6	1.9	5.2	2.0	0.6
1932-33	18.2	..	9.1 ⁴	1.9	5.2	2.5	0.6
1933-34	16.6	..	10.9	2.1	4.7	2.5	0.7

¹ This table has been compiled with the assistance of the National Industrial Conference Board, New York. The figures of *per capita* expenditure were converted into £s sterling at the par rate of exchange and were then divided by the index number of wholesale prices for the year (1913=100), country by country. Thus in the case of the United States the *per capita* expenditure in 1925-26 was \$96.41 or £19.8. The index number of wholesale prices was 148. The *per capita* figure allowing for prices was thus $\frac{19.8 \times 100}{148} = £13.4$.

² In the case of France the fiscal year refers to calendar year the major portion of which falls within the fiscal years of other governments, i.e. in the fiscal year 1902-03 the comparable fiscal year taken for France is the calendar year 1902.

³ Fiscal year 1903-04.

⁴ April to December 1932 only.

The figures given above generally include Central, Provincial or State and Local Governments as far as possible.

SOURCE—Official publications.

TABLE VIII

THE PERCENTAGE OF PUBLIC EXPENDITURE TO NATIONAL INCOME

APPENDIX

1083

Country.	Currency.	Pre-War Year.		Post-War Years.	
		National Income.	Expenditure of Governments.	Percentage of Expenditure to National Income.	National Income.
The United Kingdom	£ millions	2,250	197.5	8.8	3,500 ¹
India	Rs. crores	1,942	..	..	851
Central	"	..	124	6.4	137
Provincial	"	..	..	..	91
Total	"	..	..	..	228
Canada	\$ millions	1,500	..	..	..
Dominion	"	..	127.4	8.5	5,938 ³
Provincial	"	..	45.8 ⁴	3.1	153 ⁴
Total	"	..	173.2	11.6	504
Australia	£ millions	258	..	..	..
Commonwealth	"	..	21.7	8.4	..
States	"	..	45.5 ³	17.6	650 ³
Total	"	..	67.2	26.0	..
U.S.A.	\$ millions	34,400	..	..	..
Federal	"	..	692	2.0	48,894 ⁶
States	"	..	383	1.1	4,861
Local	"	..	184.4	5.5	2,506
Total	"	..	291.9	8.6	5,007
France	Fr. millions	37,500	4739	12.6	12,374
Japan	Yen millions	3,184	416.9	13.1	42,445
Italy	L. millions	20,000	2127	10.6	20,382 ⁷
Germany	R.M. millions	45,693	3330	7.3	1,525
					11.4
					20,841
					22.2
					8,219
					17.7

Note.—Only ordinary expenditure of Central and Provincial Governments has been taken. The nature of public expenditure differs in different countries, especially in regard to expenditure on social services, and therefore in making comparisons of the percentage which this expenditure bears to national income this fact among others has to be remembered. Purely local bodies have not been included for lack of sufficient data.

¹ Latest figure for 1931-32.

² Latest figure for 1932-33.

³ Excises paid by the Dominion to the States.

⁴ Excises Commonwealth subsidies to States.

⁵ New estimates of National Incomes; Harvey and Fisk, *American Economic Review*, No. 1, March 1930, p. 23.

⁶ Estimates for 1935, *The Economist*, November 24, 1934.

⁷ Estimates for 1935, *Encyclopaedia of the Social Sciences*, vol. II, p. 206.

TABLE IX
CLASSIFICATION OF REVENUE

GROSS REVENUE OF THE UNITED KINGDOM (IN MILLIONS OF POUNDS) CLASSIFIED

Heads of Revenue.	1901-02.	1911-12.	1913-14.	1919-20	1921-22.	1926-27.	1927-28	1928-29.	1929-30	1930-31.	1931-32	1932-33	1933-34
A. TAX REVENUE													
I. Direct taxes—													
Income tax	34.8	44.8	47.2	359.1	398.8	300.6	311.2	203.8	203.8	323.9	364.1	312.2	281.5
Estate, etc., duties	14.2	25.4	27.4	40.9	52.2	67.3	77.3	80.6	79.8	82.6	65.0	77.2	65.3
Excess profit duty	..	..	..	290.0	30.5	4.5	1.7	0.8	0.8	3.0	0.6	2.5	1.8
Corporation duties	..	..	..	..	17.5	4.0	1.8	0.9	0.9	..	..	..	..
Motor duties	..	..	..	..	..	21.4	24.5	25.3	26.8	27.8	27.5	27.9	30.7
Land and house tax	2.5	2.9	2.7	..	..	2.6	0.7	0.6	0.6	0.6	0.6	0.8	0.6
Land value duties	0.5	0.7	0.7	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total direct taxes	51.5	73.6	78.0	693.3	512.8	398.7	415.6	402.2	403.5	438.1	459.9	420.3	400.1
II. Indirect taxes—													
Excise	31.6	38.4	39.6	133.7	194.3	133.0	139.2	134.0	127.5	124.0	119.9	120.9	107.0
Customs	31.0	33.6	35.5	149.4	130.1	107.5	111.6	119.9	119.9	121.4	136.2	167.2	179.2
Stamps	7.8	9.5	10.0	22.6	24.8	22.4	27.0	30.1	25.7	26.7	17.1	19.2	62.2
Total indirect taxes	70.4	81.5	86.1	305.7	344.0	265.3	277.8	283.1	273.1	266.1	273.2	307.3	308.9
Total tax revenue	121.9	155.1	163.1	999.0	856.8	664.0	693.4	685.3	676.6	704.2	733.1	727.6	709.0
85.2	83.8	82.2	74.6	76.2	82.4	82.3	81.9	83.0	82.1	86.1	88.0	87.6	..
B. NON-TAX REVENUE													
Miscellaneous	2.0	2.5	2.3	280.8	197.1	59.1	61.4	56.5	36.4	50.3	33.9	22.9	22.1
Posts and telegraphs and telephones	17.8	25.7	30.8	34.1	56.4	58.8	63.0	65.3	68.1	69.1	69.5	70.2	72.4
Sundry loans, Suez Canal shares, etc.	0.9	1.3	1.6	15.0	13.8	22.8	23.9	28.1	32.6	32.9	13.8	5.1	4.7
Crown lands	0.4	0.5	0.7	0.5	0.7	0.8	1.0	1.1	1.2	1.3	1.3	1.2	1.2
Total non-tax revenue	21.1	30.0	35.2	340.6	268.1	141.7	149.4	151.1	138.4	153.6	118.4	99.4	100.4
Grand total	143.0	185.1	198.3	1339.6	1124.9	805.7	842.8	836.4	815.0	857.8	851.5	827.0	809.4
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

TABLE X

Classification of Revenue of the Governments in India, Central
and Provincial, classified under main heads of revenue.

TABLE
CLASSIFICATION
REVENUE OF THE GOVERNMENTS IN INDIA
(In Thousands of Rupees)

Heads of Revenue.	1861-62.	1871-72.	1881-82.	1891-92.	1901-02.	1911-12.
<i>A. Tax Revenue.</i>						
I. Direct—						
Land revenue . . .	19,01,80 45·2	20,52,03 41·0	21,94,80 29·0	23,96,58 26·9	27,39,80 28·3	31,14,70 25·1
Income tax . . .	2,05,47	82,52	53,68	1,65,28	2,05,40	2,47,93
Provincial rates . . .			2,89,55	3,50,28	1,55,77	82,80
Tributes from States . . .	78,27 22,75,54 51·6	74,40 22,08,95 44·1	70,69 26,08,72 34·5	77,60 29,89,74 33·5	87,53 31,88,50 32·9	89,25 35,34,18 28·5
II. Indirect—						
Opium . . .	6,35,93	9,25,39	9,86,24	8,01,24	7,27,80	8,94,19
Salt . . .	4,56,33	5,96,66	7,37,56	8,63,62	8,90,90	5,08,68
Excise . . .	1,78,62	2,36,91	3,42,73	5,11,73	6,11,50	11,41,46
Customs . . .	2,85,19	2,57,60	2,36,14	1,70,13	5,74,95	9,70,29
Stamps . . .	1,69,32	2,47,62	3,38,14	4,26,22	5,16,96	7,22,27
Registration . . .			28,47 26,69,28 45·3	39,98 28,12,92 35·2	46,94 33,69,05 31·6	66,88 43,03,77 34·6
Total tax revenue . . .	40,00,93 90·8	44,73,14 89·4	52,78,00 69·7	58,02,66 65·1	65,57,55 67·6	78,37,95 63·1
<i>B. Non-Tax Revenue.</i>						
III. Government or public undertakings—						
Railways . . .	..	26,64	10,88,55	19,93,80	16,08,85	23,83,76
Irrigation . . .		47,16	1,47,95	2,27,20	3,79,69	5,97,01
Other public works . . .	58,89	9,20	54,68	57,73	32,84	49,04
Posts and telegraphs . . .	47,71	1,04,93	1,41,93	2,36,57	3,43,09	4,83,26
Mint . . .	38,07	9,62	7,06	21,00	83,31	55,08
Forests . . .	25,77	50,19	87,49	1,49,06	1,73,60	2,92,88
Stationery and printing . . .	..	..	5,78	8,34	9,46	14,53
Scientific and miscellaneous . . .			13,01	9,02	30,25	39,89
	1,70,44 3·9	2,47,74 5·0	15,46,45 20·5	27,02,72 30·3	26,61,09 27·5	39,15,40 31·3
IV. Receipts from social services—						
Education . . .	4,23	..	18,93	21,17	16,35	30,84
Public health . . .	..	..	4,03	6,31	8,28	10,03
	4,23 0·1	..	22,96 0·3	27,48 0·3	24,63 0·3	40,87 0·3
V. Other sources—						
Interest . . .	9,41	36,32	90,86	87,94	1,16,80	2,17,31
Military receipts . . .	1,12,24	1,14,13	4,59,93	1,05,26	1,58,73	2,01,45
Exchange . . .	..	1,37	..	3,15	3,82	13,85
Superannuation . . .	..	68,27	37,81	36,15	28,96	30,22
Miscellaneous . . .	1,07,55 2,29,20 5·2	70,05 2,90,14 5·6	1,32,49 7,21,09 9·5	1,48,95 3,81,45 4·3	1,43,23 4,51,54 4·6	1,66,31 6,31,15 5·1
Total non-tax revenue . . .	4,03,87 9·2	5,37,88 10·6	22,90,50 30·3	31,10,65 34·9	31,37,26 32·4	45,87,42 36·9
Grand total . . .	44,04,80 100·0	50,11,02 100·0	75,68,50 100·0	89,14,31 100·0	96,94,81 100·0	124,25,87 100·0

a Included in Land Revenue.

b Included under Miscellaneous.

SOURCE.—*Finance and Revenue Accounts of the Government*

X
OF REVENUE

(CENTRAL AND PROVINCIAL) CLASSIFIED
and in Percentages.)

1913-14.	1919-20	1921-22.	1926-27.	1929-30	1930-31	1931-32	1932-33	1933-34
32,08,74 25·1	33,91,49 17·2	34,87,44 17·2	35,04,06 14·8	33,58,20 13·6	30,39,99 13·3	33,13,29 14·8	31,02,34 13·6	30,11,57 13·6
2,92,54 27·03	23,20,78 5·35	25,11,53 a	17,47,05 36·57	18,91,64 40·62	17,85,23 32·49	19,11,97 43·40	19,65,87 41·67	19,03,90 41·53
92·53 36,20,84	93·29 58,10,91	87·21 60,86,18	84·90 53,72,58	73·99 53,64,45	(63,60 49,21,31	85·95 53,54,61	74·85 51,84,73	76·24 50,33,33
28·3	29·4	30·0	22·8	21·7	21·6	24·0	22·7	22·7
2,43,73 5,16,80	4,55,62 5,74,79	3,07,25 6,44,20	4,41,82 6,72,86	3,04,10 6,80,88	2,53,29 6,90,52	2,07,43 8,78,09	89,86 10,38,46	1,58,97 9,05,92
13,84,15 11,33,73	19,25,94 22,48,33	17,30,12 35,36,31	19,95,89 48,30,54	20,63,23 52,03,67	16,92,85 47,84,29	15,08,71 47,71,77	15,09,74 53,31,62	15,16,56 48,55,15
7,97,74 77,84	10,91,18 1,08,55	11,12,12 1,13,86	13,43,28 1,45,97	14,36,83 1,37,23	12,83,11 1,16,39	12,17,22 1,09,73	13,11,10 1,13,69	12,46,41 1,12,84
41,03,99 32·1	64,04,41 32·4	74,43,86 36·7	94,30,36 40·0	98,25,94 39·6	88,20,45 38·7	86,92,95 38·9	93,94,47 41·2	87,95,85 39·7
77,24,83 60·4	122,15,32 61·8	135,30,04 66·7	148,02,94 62·8	151,90,30 61·3	137,41,76 60·3	140,47,56 62·9	145,79,20 68·9	138,20,18 62·4
26,43,85 7,06,97	31,96,92 8,74,93	15,23,00 9,40,70c	34,00,33 11,15,55c	37,19,47 13,67,30c	39,16,08 12,90,14c	33,63,17 12,19,89c	33,38,09 12,12,90c	33,05,44 13,60,42c
44·80 5,39,78	55,49 9,20,62	73,76 9,55,03c	85,00 10,93,15c	1,28,34 11,55,46c	1,66,53 10,99,40c	1,99,13 10,64,60c	1,92,70 10,55,40c	1,84,24 10,72,62c
50·98 3,34,48	2,67,99 5,36,76	4,37,42 5,83,29	4,15,51 6,18,84	2,73,69 6,12,51	1,24,30 4,73,34	1,78,61 3,09,84	2,30,63 3,76,58	1,33,41 3,53,38
14,01 43·11	19,90 95·23	22,59 1,03,79	36,31 1,33,04	65,28 1,75,81	68,29 3,13,99	55,76 4,02,49	49,34 4,06,35	45,76 2,12,50
43,77,98 34·3	59,67,84 30·2	46,39,58 22·9	69,06,73 29·3	74,97,86 30·3	74,52,07 32·7	68,83,49 30·8	69,62,84 30·5	66,76,77 30·2
87,19 12,05 49·24 0·4	48,60 24,18 72,78 0·4	51,91 28,10 80,01 0·5	74,33 51·81 1,26,14 0·7	91,50 86,84 1,78,34 0·8	89,68 83,40 1,73,08 0·9	92,04 99,48 1,91,52 0·9	93,68 92,66 1,86,34 0·8	90,17 92,57 1,91,74 0·9
2,02,82 2,05,45 17·96	6,58,00 4,05,24 b	2,18,90 8,06,94 b	6,44,23 4,94,68 .	6,84,16 3,98,09 .	5,78,63 3,98,90 .	4,62,96 4,12,74 .	4,15,36 3,63,50 .	3,80,19 5,32,62 .
31,02 1,71,78	34,39 3,95,03	57,91 9,42,87	79,18 5,19,87	62,97 7,64,83	46,10 4,08,80	40,86 3,04,24	39,74 2,79,85	35,65 4,82,02
6,29,03 4·9	14,92,66 7·6	20,26,62 10·0	17,37,96 7·4	19,10,05 7·7	14,32,43 6·2	12,20,80 5·4	10,98,45 4·8	14,38,48 6·3
50,56,25 39·6	75,33,28 38·2	67,46,21 33·3	87,70,83 37·2	95,86,25 38·7	90,57,58 39·7	82,95,81 37·1	82,47,63 36·1	82,08,90 37·6
127,81,08 100·0	197,48,60 100·0	202,76,25 100·0	235,73,77 100·0	247,76,64 100·0	227,99,34 100·0	223,43,37 100·0	228,26,83 100·0	221,28,17 100·0

c The working expenses have been included to get the figures in line with the previous year's figures.
of India, Government of India Press, New Delhi.

TABLE XI
 CLASSIFICATION OF THE REVENUE OF LOCAL BODIES—INDIA
 STATEMENT SHOWING THE ORDINARY REVENUE OF MUNICIPALITIES AND DISTRICT AND LOCAL BOARDS IN INDIA
 (In Thousands of Rupees.)

	1891-92.	1901-02.	1911-12.	1913-14.	1919-20.	1921-22.	1926-27.	1927-28.	1928-29.	1929-30.	1930-31.	1931-32
Municipal rates and taxes	2,35,00	3,52,79	5,05,70	5,46,65	7,41,52	8,68,63	11,68,32	11,96,39	12,59,37	12,64,87	12,68,32	12,43,80
Realisation under special Acts	..	5,84	8,51	10,57	13,72	14,02	16,94	16,88	17,04	16,48	15,81	15,21
Other sources of revenue	1,04,56	1,06,54	2,31,39	3,18,99	3,85,80	4,13,38	4,98,09	4,87,26	4,89,74	5,07,18	4,73,49	4,61,99
Total municipalities	3,39,56	4,65,17	7,45,60	8,76,21	11,41,04	12,96,03	16,83,35	17,00,53	17,36,15	17,88,53	17,57,62	17,21,00
Provincial rates	1,65,03	2,03,21	2,31,29	3,00,97	3,75,27	3,94,63	4,90,36	4,83,71	4,91,50	4,94,18	4,96,62	4,82,87
Civil works	23,80	40,04	1,32,39	2,07,76	1,72,35	1,79,72	2,52,46	2,57,78	2,56,62	2,66,59	2,52,18	2,05,00
Other sources of revenue	1,06,44	1,12,07	1,85,90	2,75,06	4,92,69	5,18,75	7,66,34	8,14,53	8,59,10	8,75,81	9,08,25	8,64,61
Total district and local Boards	2,95,27	3,55,32	5,49,58	7,83,79	10,40,31	10,93,10	15,09,16	15,56,02	15,98,22	16,36,58	16,57,05	15,52,48
Grand total	6,34,83	8,20,49	12,95,18	16,60,00	21,81,35	23,89,13	31,92,51	32,56,55	33,34,37	34,25,11	34,14,67	32,73,48

SOURCE.—Statistical Abstracts for British India.

TABLE XII

DISTRIBUTION OF REVENUE

TABLE SHOWING THE PERCENTAGE DISTRIBUTION OF THE GROSS REVENUE OF THE CENTRAL AND PROVINCIAL GOVERNMENTS IN INDIA

(For details see Table X)

TABLE XIII
THE BURDEN OF TAXATION
TAXATION BEFORE AND AFTER THE WAR
(In various Countries)

Country.			Tax Revenue.			Index Nos of the	
			Pre-War Year 1913-14.	Post-War Year.	Increase Per Cent.	Cost of Living.	Whole-Sale Prices.
The United Kingdom—							
National . . .	£ millions	163 1	683 4 ²	319		(1913-1 141 ²)	4 = 100 105 ³
Local ¹ . . .		92 6	171 9 ²	85			
Total : : .	"	255 7	855 3	234			
India—							
Central . . .	Rs Crores	77 25	79 84 ⁴	79	100 ⁶	95 ⁷	
Provincial . . .			58 44 ⁴				
Local . . .	"	7 17	17 27 ⁵	140			
Total : : .	"	84 42	155 55	84			
Canada—							
Dominion . . .	\$ millions	127	275 0 ⁶	117			
Provinces . . .		20 ⁸	92 6 ⁶	363	143 ³	113 ⁵	
Local . . .	"	50 ⁹	251 2 ⁵	402			
Total : : .	"	197	618 8	214			
Australia—							
Commonwealth . .	£ millions	16 6	56 2 ¹⁰	239			
States . . .		6 3	37 3 ¹⁰	492	119 ¹⁰	127 ¹⁰	
Local . . .	"	4 0 ¹¹	21 6 ¹⁰	440			
Total : : .	"	26 9	115 1	328			
The Union of South Africa—							
Union . . .	£ millions	8 5	16 2 ¹⁰	96	115 ¹⁰	89 ¹⁰	
Provinces . . .		1 2	3 7 ¹⁰	208			
Local . . .	"	1 1	0 9 ¹²	.			
Total : : .	"	10 8	20 8	93			
The United States—							
Federal . . .	\$ millions	672 4	1,855 2 ¹⁰	176	130 ¹⁰	90 ¹⁰	
State . . .		306 0 ¹³	1,967 0 ¹⁰	542			
Local . . .	"	1219 8 ¹⁴	5,124 0 ¹⁰	320			
Total : : .	"	2198 2	8,946 2	307			
France—							
National . . .	Fr. millions	3843	36,306 0 ¹⁵	845	87 ¹⁷	81 ¹⁸	
Local . . .		1350	13,547 0 ¹⁶	903			
Total : : .	"	5193	49,853 0	860			
Germany—							
National . . .	{ Gold marks millions	4730	6634 1 ⁹	40	135 ¹⁹	119 ¹⁹	
Japan—							
National . . .	Yen millions	369 5	974 3 ⁶	164	135 ⁵	116 ⁵	
Local . . .		178 5	856 5 ²⁰	380			
Total : : .	"	548 0	1830 8	234			
Switzerland—							
Federal . . .	Fr. millions	84 1	396 0 ²¹	371			
Cantonal . . .		102 4	299 4 ²¹	192	138 ²¹	96 ²¹	
Local . . .	"	92 0	258 6 ²¹	181			
Total : : .	"	278 5	954 0	243			

¹ Revenue from tolls, dues, and duties (excludes Government contributions).

² 1934-35.

³ Board of Trade Index for 1934-35.

⁴ 1933-34.

⁵ 1931-32

⁶ Yearly average for 1933-34 of the Bombay Cost of Living Index.

⁷ Yearly average of the Bombay and Calcutta Index for 1933-34.

⁸ 1915-16. The total receipts in 1915-16 were nearly equal to those in 1913-14.

⁹ Half of the tax revenue for 1919-20 has been taken, as exact figures were not available

¹⁰ 1932-33.

¹¹ A third of the figures for 1920-21 has been taken, as exact figures were not available.

¹² 1931.

¹³ 1913

¹⁴ Taxation and National Income—Bulletin No. 55 of the National Industrial Conference Board—New York, U.S.A.

¹⁵ 1933.

¹⁶ 1930

¹⁷ Average for 1933. Base 1930=100.

¹⁸ Average for 1933.

¹⁹ 1930-31.

²⁰ 1929-30.

²¹ 1932.

TABLE XIV
THE BURDEN OF TAXATION
PER CAPITA TAXATION BEFORE AND AFTER THE WAR
(In various Countries)

Country.	Currency of Country.	Taxation per Head.					
		Pre-War Years.			Post-War Years. ¹		
		In Currency of Country	In Sterling ²	In Currency of Country	In Sterling ²		
The United Kingdom—							
National	£	3 55	3 11 0	15 05	15 1 0		
Local	"	2 01	2 0 2	3 78	3 15 7		
Total	"	5 56	5 11 2	18 83	18 16 7		
India—							
Central }	Rupees	3 12	0 4 2	{ 2 9	0 4 5		
Provincial }		0 30	0 0 5	2 2	0 3 3		
Local	"	3 42	0 4 7	0 6	0 0 11		
Total	"			5 7	0 8 7		
Canada—							
Dominion	Dollars	16·6	3 8 2	26·51	5 17 0		
Provinces		3 0	0 12 5	8 93	1 19 10		
Local	"	6 9	1 8 5	24 21	5 8 0		
Total	"	26·5	5 9 0	50 65	13 4 10		
Australia—							
Commonwealth	£	3·4	3 8 0	8 61	6 17 5		
States	"	1·3	1 6 0	5 72	4 11 2		
Local	"	0·9	0 18 0	3 31	2 12 7		
Total	"	5 6	5 12 0	17 64	14 1 2		
The Union of South Africa—							
Union	£	1 45	1 0 0	1 99	2 10 7		
Provinces	"	0 24	0 4 9	0 45	0 11 6		
Local	"	0 20	0 4 0	0 11	0 2 10		
Total	"	1 89	1 17 9	2 55	3 4 11		
The United States of America—							
Federal	Dollars	6·30	1 7 11	15 11	4 8 10		
States	"	2·80	0 11 7	16·02	4 12 2		
Local	"	11·17	2 6 0	41 74	12 5 7		
Total	"	20·27	4 5 6	72 87	21 6 7		
France—							
National	Frances	84·5	3 7 0	867 8	10 5 2		
Local	"	34·1	1 7 0	323·8	2 12 2		
Total	"	118·6	4 14 0	1191·6	12 17 4		
Germany—							
National	Gold marks	31·3	1 10 8	102·66	5 0 5		
Japan—							
National	Yen	6·93	0 14 2	15 12	1 12 7		
Local	"	3·34	0 6 9	13·29	1 7 2		
Total	"	10·27	1 0 11	28·41	2 19 9		
Switzerland—							
Federal	Frances	21·5	0 17 0	97·30	5 7 0		
Cantonal	"	26·2	1 0 7	73·63	4 1 0		
Local	"	23·7	1 6 7	63·60	3 10 0		
Total	"	71·4	3 4 2	234·62	12 18 0		

NOTE.—These figures have been arrived at from the tax revenue of various countries given in Table XIII.

¹ For the years please refer to the footnotes to Table XIII.

² The various currencies for the pre-war years have been converted into sterling at par of exchange, e.g. 4·867 = £1 or 25·225 Fr. = £1; for the post-war years at the current rate of exchange.

TABLE XV

THE BURDEN OF TAXATION

PER CAPITA TAXATION IN VARIOUS COUNTRIES ALLOWING FOR PRICES¹

Fiscal year. ²	United Kingdom.	United States.	France.	Italy.	Germany	Japan.	India.
1902-03	4.8	3.6	3.4	2.0	2.4 ³	0.6	0.3
1912-13	5.4	4.7	4.4	2.5	3.8	1.1	0.3
1913-14	5.6	4.7	4.6	2.5	4.0	1.2	0.3
1914-15	5.9	4.9	3.9	2.1	4.1	1.2	0.2
1915-16	6.4	4.5	2.7	1.8	2.6	1.1	0.3
1916-17	7.9	4.0	2.4	1.8	2.7	1.0	0.3
1917-18	7.3	6.4	2.1	1.4	5.0	0.8	0.3
1918-19	8.6	6.5	1.8	1.6	4.2	0.9	0.3
1919-20	9.2	7.1	2.6	1.5	3.9	0.9	0.2
1920-21	9.5	8.3	3.1	1.6	4.0	1.1	0.3
1921-22	11.4	9.3	5.0	0.7	2.9	0.7	0.2
1922-23	10.4	8.6	4.9	0.6	..	0.8	0.2
1923-24	9.2	9.4	5.4	0.6	..	1.1	0.2
1924-25	9.2	8.8	5.6	0.7	4.1	0.9	0.3
1925-26	9.6	10.7	5.3	0.7	3.7	0.7	0.3
1926-27	9.8	11.6	4.3	0.6	3.8	0.7	0.3
1927-28	10.8	12.4	5.5	0.8	4.5	0.8	0.3
1928-29	10.7	11.5	5.7	0.9	5.0	0.8	0.3
1929-30	10.8	12.5	6.1	0.9	6.0	0.9	0.3
1930-31	12.8	12.1	7.0	1.2	6.9	1.0	0.4
1931-32	15.3	15.4	8.1	1.3	..	1.0	0.4
1932-33	15.5	..	8.7	1.4	5.9	0.9	0.4

¹ Because of the paucity of sufficiently comparable data, no attempt has been made to take cognisance of the price changes prior to the World War, i.e. internal purchasing power was considered more or less stationary, with changes deemed relatively insignificant for the general purposes at hand. The figures for each year were divided by the index number of wholesale prices in each country in the same period in order to arrive at pounds of pre-War purchasing power. See footnote 1 to Table VII.

² In the case of France, the fiscal year refers to the calendar year, the major portion of which falls within the fiscal years of other governments, i.e. in the fiscal year 1902-03; the comparable fiscal year taken for France is 1902.

³ Fiscal year 1903-04.

The above figures generally include Central, Provincial or State and Local Governments as far as possible. The conversions from one currency to another have been at par of exchange.

TABLE XVI

The Burden of Taxation Taxation and National Income.

TABLE XVI
THE BURDEN OF TAXATION
TAXATION AND NATIONAL INCOME

Country.	Currency.	Pre-War Year 1913-14.			Post-War Year.		
		National Income.	Taxation.	Percentage of Taxation to National Income.	National Income.	Taxation. ¹	Percentage of Taxation to National Income.
The United Kingdom	£ millions	2,250 ²	163.1	..	3,500	..	..
National taxation	"	..	92.6	7.3	..	733	20.9
Local taxation	"	..	255.7	4.1	..	165	4.7
Total	"	..	..	11.4	..	898	25.6
India	Rs. crores	1,942 ²	..	..	1,600	..	..
Central taxation	"	..	{ 77.25	4.0 }	..	83.2	5.2
Provincial taxation	"	..	7.17	0.4	..	60.7	3.8
Local taxation	"	..	84.42	4.4	..	17.6	1.1
Total	"	..	..	..	..	161.5	10.1
Canada	\$ millions	1,500 ³	..	..	5,938	..	..
Dominion taxation	"	..	127	8.4	..	396	6.7
Provincial taxation	"	..	20	1.3	..	77	1.3
Local taxation	"	..	50	3.3	..	100	1.7
Total	"	..	197	13.0	..	573	9.7

Australia	.	.	.	£ millions	258.4	16.6	6.4	..	56.6	8.7
Commonwealth taxation	.	.	.	"	..	6.3	2.5	..	32.3	5.0
State taxation	.	.	.	"	..	4.0	1.5	..	9.6	1.5
Local taxation	.	.	.	"	..	26.9	10.4	..	98.5	15.2
Total	.	.	.	"	..	..	..	..	..	..
The United States	.	.	.	\$ millions	34,400 ⁵	672.4	2.0	..	1,863	3.8
Federal taxation	.	.	.	"	..	306.0	0.9	..	1,642	3.4
State taxation	.	.	.	"	..	1219.8	3.5	..	3,272	6.7
Local taxation	.	.	.	"	..	2198.2	6.4	..	6,777	13.9
Total	.	.	.	"	..	..	..	..	..	..
France	.	.	.	Fr. millions	37,500 ⁶	..	..	210,000	..	..
National taxation	.	.	.	"	..	3843	10.2	..	38,460	18.3
Local taxation	.	.	.	"	..	1350	3.6	..	..	..
Total	.	.	.	"	..	5193	13.8	..	1,134	8.5
Germany—National taxation	.	.	.	{ Gold marks } { millions }	45,000	4730	10.5	..	225	1.7
Japan	.	.	.	Yen millions	3,184.4	369.5	11.6	..	357	2.6
National taxation	.	.	.	"	..	178.5	5.6	..	1,716	12.8
Local taxation	.	.	.	"	..	518.0	17.2	..	15,466	16.5
Total	.	.	.	State, Provincial and Local	16,000 $\frac{4,000}{20,000}$	1939	9.6	..	3,674.8	3.9
Italy—National taxation	.	.	L. millions	..	..	..	..	19,140	20.4	..

¹ The figures of taxation are for those years for which the National Income figures are available. For details regarding the years of the National Income see footnotes to Table VIII.

² See "Finance of the Dominion of Canada" (H. E. Fisk, Bankers' Trust Company, N.Y., 1922).

³ "Public Finance and Income of the Chief Powers" (Stamp, *Journal of the Royal Statistical Society*, 1922).

⁴ "Wealth and Income of the Nation" (National Industrial Conference Board, N.Y., 1924).

⁵ "National Income and Taxation" (Bulletin No. 55, National Industrial Conference Board, N.Y., 1924).

⁶ Cf. also Fisk, *French Public Finance* (Bankers' Trust Company Publication, New York, 1922).

⁷ *Inter-Ally Datab.*, p. 290 (Fisk, Bankers' Trust Company Publication, New York, 1924).

⁸ Latest available figure (1935).

SOURCE.—Official publications and *Tax Systems of the World* (Chicago, The Tax Research Foundation), 5th edition, 1934 (cf. 6th edition, 1935).

TABLE XVII
THE BURDEN OF TAXATION
TAXATION IN INDIA

(For details see Tables X. and XI)

Year	Taxation			Per Capita Taxation.		
	Central and Provincial	Local	Total	Central and Provincial	Local	Total
1891-92	1000 Rs	1000 Rs	1000 Rs	Rs.	Rs.	Rs.
1901-02	58,02,61	4,00,03	62,02,64	2.9	0.2	3.1
1911-12	65,57,55	5,56,00	71,13,55	2.8	0.2	3.0
1913-14	78,37,96	7,36,99	85,74,95	3.2	0.3	3.5
1914-15	77,24,82	8,47,62	85,72,44	3.2	0.3	3.5
1915-16	75,24,20	8,78,01	84,02,21	3.1	0.4	3.5
1916-17	76,18,79	9,19,40	85,38,19	3.1	0.4	3.5
1917-18	87,95,49	9,64,48	97,59,97	3.6	0.4	4.0
1918-19	96,86,03	9,94,80	106,80,83	3.9	0.4	4.3
1919-20	100,96,14	10,52,97	111,49,11	4.1	0.4	4.5
1920-21	122,15,32	11,16,79	133,32,11	4.9	0.5	5.4
1921-22	129,85,33	11,63,43	141,48,81	5.3	0.5	5.8
1922-23	135,30,04	12,63,26	147,93,30	5.5	0.5	6.0
1923-24	145,15,60	13,96,04	159,05,63	5.9	0.5	6.4
1924-25	145,41,53	14,73,42	160,14,95	5.9	0.6	6.5
1925-26	149,58,93	15,66,65	165,25,58	6.0	0.6	6.6
1926-27	149,69,34	16,13,93	165,83,27	6.0	0.7	6.7
1927-28	148,00,94	16,58,68	164,59,62	6.0	0.7	6.7
1928-29	149,28,74	16,80,10	166,08,84	6.0	0.7	6.7
1929-30	149,94,97	17,20,86	167,15,83	6.1	0.7	6.8
1930-31	151,90,39	17,59,05	169,49,44	6.1	0.7	6.8
1931-32	137,41,76	17,65,24	155,07,00	5.6	0.7	6.3
1932-33	140,47,56	17,26,67	157,74,23	5.2	0.6	5.8
1933-34	145,79,20	1	1	5.4	1	1
	138,29,18	1	1	5.1	1	1

¹ Not available.

The Reforms introduced in 1921-22 have given Provincial Governments greater financial independence. It is advisable, therefore, to show the data for provinces separately

Year.	Taxation.				Per Capita Taxation.			
	Central.	Provincial.	Local.	Total.	Central.	Provincial.	Local	Total
1921-22	1000 Rs.	1000 Rs.	1000 Rs.	1000 Rs.	Rs.	Rs.	Rs.	Rs.
1922-23	68,57,06	66,72,96	12,63,26	147,93,30	2.8	2.7	0.5	6.0
1923-24	78,33,43	66,82,17	13,96,04	150,05,64	3.2	2.7	0.5	6.4
1924-25	77,29,34	68,12,14	14,73,42	160,14,95	3.2	2.7	0.6	6.5
1925-26	79,69,58	69,89,35	15,66,65	165,25,98	3.2	2.8	0.6	6.6
1926-27	78,72,63	70,96,71	16,13,93	165,83,27	3.2	2.8	0.7	6.7
1927-28	78,53,33	69,47,61	16,58,68	164,59,62	3.2	2.8	0.7	6.7
1928-29	78,50,10	70,78,64	16,80,10	166,08,84	3.2	2.8	0.7	6.7
1929-30	82,41,89	69,48,50	17,59,05	169,49,44	3.3	2.8	0.7	6.8
1930-31	76,57,15	60,84,61	17,65,24	155,07,00	3.1	2.5	0.7	6.3
1931-32	79,44,22	61,03,34	17,26,67	157,74,23	2.9	2.3	0.6	5.8
1932-33	83,76,67	60,02,53	1	1	3.2	2.2	1	1
1933-34	79,84,33	58,44,85	1	1	2.9	2.2	1	1

¹ Not available.

TABLE XVIII

THE BURDEN OF TAXATION
DIRECT AND INDIRECT TAXATION IN VARIOUS COUNTRIES

	Great Britain		India		Canada		Australia		South Africa		U.S.A.		France		Italy		Japan			
	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14	1913-14		
<i>Direct Taxes.</i>																				
Inland Revenue	Million £	Million £	Lakhs Rs	Million £	Million £	Million \$	Million £	Million £	Million £	Million £	Million \$	Million \$	Million Fr.	Million Lire	Million Yen	Million Lire	Million Yen	Million Yen		
Income tax and super tax	0·7	281·5	32,09	30,12	..	61·3	..	18·7	..	..	..	..	..	..	..	..	..	..
Estate, etc., duties	47·2	85·3	2,92	19,04	..	47	..	..	..	..	..	..	..	..	..	..	..	..
Capital levy	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
House duty	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Land value duties	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Excess profits duty	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Corporation profits duty	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
War-time tax	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Other direct taxes	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Total direct taxes	78·0	400·1	36,21	50,34	12·7	149·9	1·6	17·1	3·1	15·0	73·9	901·1	151·9	53·8	4,476·6	113·6	238·6	24·5		
<i>Indirect Taxes.</i>																				
Excise	39·6	107·0	13·34	15·16	21·5	48·6	2·3	9·8	0·6	1·8	306·2	448·8	678	4,911	210·2	1,862·9	140·9	315·0		
Customs	35·5	117·2	11·34	48·55	104·7	104·1	12·7	18·6	4·7	8·7	292·3	250·8	625	4,724	266·7	3,197·7	116·5	116·5		
Stamps	22·7	7·98	12·46	4·1	0·4	0·9	244	85·0	1,197·2	30·8	65·4	
Registration	1·13	78	3·8	3,553	96·5	639·7	27·4	52·7
Business tax.	
Turnover tax	
Entertainments tax	
Monopolies	
Other indirect taxes	
Total indirect taxes	85·1	308·9	41·04	87·95	134·1	217·7	15·0	36·9	6·6	11·4	598·5	961·8	17·7	3,723	232·1	3,628·6	118·3	12,091·5	286·7	
Grand total tax revenue	163·1	709·0	77·25	1,382·9	146·8	367·6	16·6	54·0	9·7	26·4	672·4	1,862·9	384·3	36·306	1731·9	16,571·1	400·3	974·3	100·0	
	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0		

PUBLIC DEBT BY COUNTRIES (Millions of Pounds Sterling)

Country.	1718.	1763.	1793.	1816.	1848.	1870.	1889.	1900.	1913 (Pre-War).	Per Capita.			
										1900.	1913.	Post-War Year 1933-34, Debt in £ the Currency of the Country in millions.	Debt in £ 1933- 1934.
The British Empire—										£. Rs.	£. Rs.	£. Rs.	£. Rs.
Great Britain	54	147	370	900	773	801	698	629	706	8,030	8,030	15,8	173
Canada	29	51	108	186	226	307	1,220	1,220	17	3
Australia	5	17	49	55	69	3,141	645	10	62
New Zealand	37	171	204	335	1,223	333	14	183
South Africa	48	92	303	303	12	205
Foreign countries—										..	274	..	32
U.S.A.	110	17	26	10	485	221	245	27,053	5,358	3	8
France	48	32	140	200	501	1269	1815	319,831	2,574	28	4
Germany	39	69	148	435	448	1055	1,407	673	2	16
Italy	25	36	333	400	686	611	104,230	18	0	16
Belgium	25	25	28	77	105	56,892	325	15	12
Austria	15	42	99	125	340	580	358	510	510	14	11
Spain	11	20	117	113	285	260	382	Peseta	2,328	19	10
Holland	7	20	110	114	76	89	97	Guilder	2,150	24	4
Japan	10	10	50	53	97	Yen	281	18	3
Russia	47	145	90	342	753	656	Roubles	8,683	87	1
Portugal	1	1	17	59	177	Escudo	10,089	6	0
Denmark	12	12	13	11	20	130	Krone	7,400	35	8
Norway	2	6	20	10	20	Krona	1,334	5	17
Sweden	83	4	17
Switzerland	3,490	12	3
Greece	86	18	1
Romania	10	18	23	39	48	Dr.	4,296	16	16
Servia	66	Leu.	133,624	16	16
Czecho-Slovakia	27	Koruna	37,325	227	2
Hungary	5,126	4	17
Poland	2,340	12	3
Bulgaria	1,826	18	1
Turkey	4,966	16	16
Egypt	115	16	7
Argentina	Peso	3,651	913	2
Latvia	Lat.	1,106	42	..
Finland	Markka	4,754	246	..
China	Peso	4,092	102	..
Chile	Real	1,100	9	12
Brazil	Mireis	15,249	1,711	..
Total	119	283	610	1649	1719	5827	3741	8805	8805	28,777	..
No. of countries	4	4	10	12	17	21	23	33	33	33	..

The various currencies for the pre-war years have been converted into sterling at par of exchange, e.g. \$4.8677 = £1, or 26.2295 Fr = £1; for the post-war years at the current rate of exchange.

TABLE XX

The Public Debt of India.

TABLE XX.—THE PUBLIC DEBT OF INDIA

Year ending 31st March.	Debt in India			Debt in England			Total Liabilities			Productive Debt			Per Head							
	Permanent, Temporary ¹	Temporary ¹	Debt in India		Other Liabilities	In India	In England	Total	Railways	Irriga- tion and other Works	Total I Pro- ductive (Col 10 and 11)	Ordinary 2	Total Debt (Col 12 and 13)	Ordinary 1 (Col 13)						
			2	3	4	5	6	7	Lakhs Rs	Lakhs Rs	Lakhs Rs	Lakhs Rs	Lakhs Rs	Lakhs Rs	Lakhs Rs					
1882	88,65	..	Lakhs Rs	Lakhs Rs	Lakhs Rs	Lakhs Rs	Lakhs Rs	Lakhs Rs	10,13	98,78	68,14	166,92	40,85	18,44	Rs. 5,4					
1892	102,69	..	106,03	107,40	114,17	114,40	10,40	10,40	12,17	106,32	105,77	222,04	105,77	50,29	166,92	Rs. 3,0				
1893	102,94	..	106,03	107,40	114,17	114,40	10,40	10,40	12,17	106,03	105,77	222,04	105,77	50,29	166,92	Rs. 3,0				
1894	105,65	..	107,01	108,37	116,21	117,01	9,00	9,00	17,39	120,32	123,82	280,35	127,58	28,92	134,09	Rs. 6,8				
1895	104,87	..	107,01	108,37	117,01	117,01	3,00	3,00	17,38	122,74	171,17	294,99	131,70	29,68	161,38	Rs. 4,4				
1896	103,79	..	107,01	108,37	117,01	117,01	3,00	3,00	19,25	123,03	173,86	296,75	136,18	30,34	166,52	Rs. 6,2				
1897	109,12	..	107,01	108,37	117,01	117,01	1,50	1,50	18,61	127,74	172,32	300,06	140,13	31,10	171,23	Rs. 6,2				
1898	111,70	..	107,01	108,37	117,01	117,01	9,00	9,00	18,45	130,15	184,91	315,06	144,39	31,90	176,29	Rs. 6,2				
1899	111,65	..	107,01	108,37	117,01	117,01	6,75	6,75	19,08	131,74	186,40	318,14	153,07	32,64	180,66	Rs. 6,2				
1900	112,47	..	107,01	108,37	117,01	117,01	6,75	6,75	19,08	131,74	186,40	318,14	153,07	32,64	180,66	Rs. 6,2				
1901	115,33	..	107,01	108,37	117,01	117,01	7,50	7,50	20,28	135,61	200,15	335,76	156,74	34,28	197,24	Rs. 6,2				
1902	116,19	..	107,01	108,37	117,01	117,01	6,00	6,00	21,70	137,89	201,46	339,35	171,74	36,16	202,99	Rs. 6,2				
1903	117,65	..	107,01	108,37	117,01	117,01	5,25	5,25	22,96	140,52	206,69	341,21	176,82	37,25	214,07	Rs. 6,2				
1904	119,42	..	107,01	108,37	117,01	117,01	3,00	24,28	143,70	199,57	343,27	183,85	38,33	222,18	Rs. 6,2					
1905	122,30	..	107,01	108,37	117,01	117,01	7,75	26,03	148,33	199,33	349,66	191,90	39,21	230,76	Rs. 6,2					
1906	126,08	..	107,01	108,37	117,01	117,01	..	21,69	153,48	219,69	373,17	223,55	40,58	264,13	Rs. 6,2					
1907	130,46	..	107,01	108,37	117,01	117,01	..	29,40	169,56	222,22	380,84	252,52	42,34	294,84	Rs. 6,2					
1908	132,83	..	107,01	108,37	117,01	117,01	..	30,36	163,19	236,22	399,41	206,55	46,11	311,36	Rs. 6,2					
1909	134,57	..	107,01	108,37	117,01	117,01	..	24,72	167,13	250,46	417,59	273,32	46,11	319,43	Rs. 6,2					
1910	136,84	..	107,01	108,37	117,01	117,01	..	24,46	9,00	32,56	167,13	264,16	435,29	279,77	48,39	328,16	Rs. 6,2			
1911	138,10	..	107,01	108,37	117,01	117,01	..	267,00	7,50	36,59	171,13	274,50	449,19	293,76	56,70	344,46	Rs. 6,2			
1912	139,96	..	107,01	108,37	117,01	117,01	..	267,73	6,75	40,28	180,24	274,48	454,72	304,52	53,60	358,12	Rs. 6,2			
1913	142,84	..	107,01	108,37	117,01	117,01	..	22,69	153,48	219,69	373,17	223,55	40,58	264,13	Rs. 6,2					
1914	146,69	..	107,01	108,37	117,01	117,01	..	265,60	10,50	49,80	195,49	265,60	461,09	332,98	59,16	392,14	Rs. 6,2			
1915	150,62	..	107,01	108,37	117,01	117,01	..	264,44	42,10	203,62	274,79	478,41	349,79	61,68	411,47	66,94	478,41	Rs. 6,2		
1916	155,46	..	107,01	108,37	117,01	117,01	..	262,76	10,50	43,00	215,38	273,26	351,54	353,61	63,68	418,54	63,89	473,11	Rs. 6,2	
1917	162,86	..	107,01	108,37	117,01	117,01	..	261,22	47,10	215,38	261,22	476,60	353,61	64,93	424,71	58,06	476,60	Rs. 6,2		
1918	170,08	..	107,01	108,37	117,01	117,01	..	255,44	79,32	62,86	312,26	355,44	667,70	358,72	65,99	424,71	62,74	422,99	Rs. 6,2	
1919	199,07	..	107,01	108,37	117,01	117,01	..	288,95	288,95	79,81	303,37	683,37	636,53	66,74	432,27	252,10	683,37	27,7	175,00	Rs. 6,2
1920	219,43	..	110,42	288,95	..	79,81	409,67	288,95	..	72,25	380,00	698,60	378,63	67,51	446,14	67,51	698,60	28,3	10,2	Rs. 6,2

1921	257,14	134,44	191,33	..	81,79	473,37	191,33	664,70	377,46	78,16	455,62	209,08	664,70	26,9	18,4	8,5
1922 ^a	303,15	53,97	401,40	..	59,59	418,71	401,40	820,11	519,89	18,75	538,64	281,47	820,11	33,2	21,8	11,4
1923	71,24	405,25	66,36	6	476,43	405,31	88,74	517,92	115,82	633,04	248,70	881,74	35,7	25,6	10,3	
1924	358,81	51,77	431,87	1,7	76,38	486,96	432,04	919,00	533,02	126,56	663,58	919,00	37,2	26,9	10,3	
1925	370,38	49,65	451,72	21	95,06	515,09	454,93	970,02	578,05	138,59	716,64	253,38	970,02	39,3	29,0	10,3
1926	368,29	49,65	456,27	28	121,87	539,81	456,35	605,61	144,21	749,82	246,54	996,36	40,3	30,4	10,0	
1927	374,44	41,47	452,12	26	137,80	563,71	452,48	1006,19	635,46	151,44	786,90	219,29	1006,19	40,7	31,9	8,9
1928	372,25	39,53	459,19	25	155,15	566,93	990,11	1026,37	668,60	160,98	829,58	196,79	1026,37	41,6	33,6	8,0
1929	390,73	43,15	471,18	57	168,83	602,71	471,75	1074,46	700,69	174,82	875,51	198,95	1074,46	43,5	35,4	8,1
1930	403,11	65,26	470,81	11,39	177,93	648,30	488,20	1136,50	730,79	182,95	913,74	229,76	1136,50	46,0	37,0	9,0
1931	417,24	61,27	511,80	6,32	173,27	651,78	518,12	1169,90	712,98	194,92	938,90	231,00	1169,90	47,7	38,0	9,4
1932	422,69	106,70	605,39	1,06	177,79	707,18	506,45	1213,64	750,73	207,98	958,41	256,22	1213,63	44,7	35,3	9,4
1933	446,89	61,57	504,15	1,21	198,02	706,48	505,36	1211,84	756,75	215,85	972,60	239,24	1211,84	44,6	35,8	8,8
1934	435,17	59,24	510,24	1,36	217,96	712,37	511,60	1223,97	757,20	220,47	977,67	246,30	1223,97	45,1	36,0	9,1
1935	438,28	54,34	511,83	1,53	233,04	725,66	513,36	1239,02	756,84	224,19	981,03	257,99	1239,02	45,6	36,1	9,5

¹ Includes Treasury Bills sold to the public and the paper currency reserve and loans from the Imperial Bank of India.² Includes Initial Capital expenditure on new capital at Delhi³ From 1922 permanent loans in England (Col. 4) includes India bills, bank loans, and provident funds, etc., in London. The way of terminable railway annuities; and temporary debt in England (Col. 5) includes India bills, bank loans, and provident funds, etc., in London.

Completeness of figures from 1922 vitiates exact comparison with previous years in respect of columns 4, 5, 8, and 9. The conversion into rupees from sterling has been at the rate of Rs. 10 = £1 up to 1893 ; from 1893-1920, £ = Rs. 15 ; for 1921 and 1922 the rate was £1 = Rs. 10 ; from 1923 onwards £1 = Rs. 13 3 (i.e. Re. 1 = 1s. 6d.).

SOURCE.—Finance and Revenue Accounts of the Government of India, and Reports of the Controller of the Currency, Government of India Press, New Delhi

TABLE XXI
ANALYSIS OF THE PUBLIC DEBT OF VARIOUS COUNTRIES

Country.	Population Millions.	Year.	Currency.	Internal Debt.			External Debt.	Proportion of	
				Funded Debt.	Floating or Unfunded Debt.	Other Liabilities.		Total.	Internal Debt.
The British Empire—									
Great Britain	45.4	1933-34	Million £	6,149.2	721.8	122.9	6,993.9	1,036.5	8,030.4
India	271.5	"	Crates of Rs.	435.2	59.2	218.0	712.4	511.6	582.0
Canada	10.4	"	Million \$	2,085.7	349.7	...	2,435.0	706.0	3,141.0
Australia	6.7	"	£	567.3	62.0	...	593.3	1,222.6	77.5
Union of South Africa	8.0	"	£	103.8	5.5	...	109.3	165.0	251.5
New Zealand	1.5	"	£	116.1	22.9	...	139.0	163.8	60.2
Foreign Countries—									
The United States	122.8	1932-33	\$	14,223.3	8,315.4	...	22,538.7	4,011.0	22,538.7
France	41.8	1933-34	Fr.	261,891.0	53,929.0	...	315,820.0	4,011.0	319,831.0
Germany	66.0	"	R.M.	8,415.8	1,931.4	...	10,347.2	2,059.9	12,407.1
Italy	41.8	1934-35	Lire	93,968.0	11,046.0	...	105,004.0	1,558.6	106,562.6
Belgium	8.2	1932-33	Fr.	29,902.0	276.0	...	30,178.0	26,714.0	56,892.0
Japan	68.2	1933-34	Yen	6,724.4	543.6	...	7,268.0	1,414.6	8,682.6
Holland	8.3	1932-33	Guilder	2,722.8	648.6	...	3,371.4	3,371.4	83.7
Denmark	3.6	1933-34	Kr.	621.6	41.6	...	663.5	670.3	1,333.8
Sweden	6.2	1934-35	Kr.	2,308.7	181.5	...	2,490.2	2,490.2	50.3
Norway	2.8	1933-34	Kr.	793.1	16.4	...	809.5	716.5	47.0

SOURCE.—Statistical Year Book of the League of Nations, 1934-35, Geneva, 1935.

TABLE XXII
RATIO OF DEBT TO ORDINARY REVENUE

Countries.	Pre-War Year, 1913-14.	Post-War Year, 1933-34.
Great Britain	3·6	9·9
India	3·6	5·4
Canada	2·1	9·7
Australia	6·2	12·5
New Zealand	8·2	14·1
South Africa	7·9	6·9
The U.S.A.	1·6	4·4
France	6·9	5·1
Italy	5·1	6·2
Belgium	4·6	5·3
Japan	4·5	5·6
Germany	2·0	2·1
Spain	7·0	5·5
Austria	1·4	1·8
Portugal	7·4	3·7
Denmark	2·7	3·1
Sweden	1·5	3·0
Norway	1·1	4·4
Greece	5·2	4·8
Holland	5·0	5·5
Switzerland	3·8	5·3

SOURCE — Official publications.

TABLE XXIII

THE BURDEN OF DEBT

PROPORTION OF EXPENDITURE ON DEBT SERVICES TO TOTAL
ORDINARY EXPENDITURE

Country.	Pre-War Year, 1913-14.	Post-War Year, 1933-34
	Percentages.	
Great Britain	12.2	28.8
India ¹	12.2	27.0
Canada ²	10.9	24.6
Australia ³ . . . .	..	27.5
New Zealand	23.5	55.4
South Africa	38.8	36.0
The United States ⁴ .	3.2	12.4
France	13.5	21.6
Germany	7.3	10.4
Belgium	27.1	24.6
Japan	36.9	16.4
Austria	Not available	14.0
Spain		22.7
Sweden	8.4	13.4
Norway	12.5	32.5
Switzerland	8.9	19.6
Netherlands	16.4	13.6

¹ Central and Provincial.² Dominion and Provinces.³ Commonwealth and States.⁴ Federal.SOURCE.—*Statistical Year Book of the League of Nations*, 1934-35 (Geneva, 1935), and other official publications.

TABLE XXIV

PAYMENTS DUE ANNUALLY BY GREAT BRITAIN ON ACCOUNT OF DEBT
TO THE UNITED STATES

(In Dollars—000,000 omitted.)

Year.	Principal	Interest.	Total.	Year.	Principal	Interest.	Total.
1923	23·0	138 0	161·0	1954	64 0	119 6	183·6
1924	23·0	137 3	160·3	1955	64 0	117 4	181·4
1925	24·0	136·6	160·6	1956	64 0	115 1	179·1
1926	25·0	135 9	160·9	1957	67 0	112 9	179·9
1927	25·0	135·2	160·2	1958	70·0	110 5	180·5
1928	27 0	134 4	161·4	1959	72 0	108 1	180·1
1929	27 0	133 6	160·6	1960	74 0	105 6	179·6
1930	28·0	132 8	160 8	1961	78 0	103 0	181·0
1931	28 0	131 9	159·9	1962	78 0	100 2	178 2
1932	30 0	131 1	161·1	1963	83 0	97 5	180·5
1933	32 0	131 9	183·9	1964	85 0	94·6	179 6
1934	32 0	150 8	182·8	1965	89 0	91 6	180 6
1935	32 0	149·7	181·7	1966	94·0	88 5	182·5
1936	32·0	148·5	180·5	1967	96·0	85·2	181·2
1937	37 0	147·4	184·4	1968	100·0	81 9	181·9
1938	37·0	146 1	183·1	1969	105·0	78·4	183·4
1939	37·0	144·8	181·8	1970	110 0	74·7	184·7
1940	42 0	143·5	185·5	1971	114·0	70·8	184·8
1941	42·0	142 1	184·1	1972	119 0	66·8	185 8
1942	42·0	140·6	182·6	1973	123 0	62·7	185·7
1943	42·0	139·1	181·1	1974	127·0	58·4	185·4
1944	46·0	137·7	183·7	1975	132 0	53·9	185 9
1945	46 0	136·0	182·0	1976	138 0	49·3	185·3
1946	46·0	134·4	180·4	1977	141·0	44·6	185·6
1947	51·0	132·8	183·8	1978	146·0	39·6	185·6
1948	51·0	131·0	182·0	1979	151·0	34·5	185·5
1949	51·0	129·3	180·3	1980	156·0	29·2	185·2
1950	53 0	127 5	180·5	1981	162·0	23·8	185·8
1951	55 0	125·6	180·6	1982	167 0	18·1	185·1
1952	57·0	123·7	180·7	1983	175 0	12·2	187·2
1953	60·0	121·7	181·7	1984	175·0	6 1	181·1
			Total .		4,600·0	6,505 8	11,105·8

TABLE XXV

COST OF THE WAR

THE COST OF THE WAR—ENTIRE PERIOD COVERING THE SIX FISCAL YEARS, 1914 TO 1919 INCLUSIVE
(In Pounds— $\text{£}000,000$ omitted.)

Nations.	Total Expenditure.	Normal Expenditure.	Direct Cost.	Loans to Allies.	Gross Cost.	Deduct Loans from Allies.	Net Cost.
<i>Allied and Associated Powers.</i>							
The British Empire—							
Great Britain	11,076.0	964.0	8,310.1	1,801.9	10,112.0	1,110.1	9,001.9
Australia	476.7	112.6	344.1	43.4	364.1	33.3	330.8
Canada	762.7	242.5	476.9	..	520.3	1.6	521.9
India	687.1	476.0	212.0	..	212.0	..	212.0
New Zealand	234.4	120.4	114.0	..	114.0	10.5	87.5
Union of South Africa	159.0	118.4	40.7	..	40.7	11.5	29.2
Crown Colonies	182.0	140.5	41.5	..	41.5	..	41.5
Total British Empire	13,677.9	2,713.4	9,593.3	1,845.3	11,404.6	1,179.8	10,224.8
Belgium	411.8	127.0	284.8	..	284.8	..	284.8
France	7,926.2	1,031.4	6,316.0	573.8	6,894.8	1,108.9	5,785.9
Greece	4,432.7	48.0	67.0	..	67.0	..	58.4
Italy	4,191.1	604.5	3,828.2	..	3,828.2	803.6	3,024.6
Japan	235.3	303.3	115.0	..	115.0	..	115.9
Portugal	308.8	84.4	141.5	..	141.5	..	122.9
Russia	6,312.7	1,212.9	224.3	..	224.3	..	139.5
Serbia	119.0	29.6	4,039.9	60.0	4,099.9	744.9	3,355.0
U.S.A.	8,105.0	588.5	555.9	1,056.0	7,516.5	81.5	7,435.0
Total Allies	40,963.6	6,296.7	30,226.2	4,440.7	34,066.9	4,454.7	30,222.2
<i>Central Powers—</i>							
Austria-Hungary	4,068.4	1,111.0	2,957.5	..	2,957.5	205.5	2,752.0
Bulgaria	261.0	97.0	161.0	..	161.0	97.8	66.2
Germany	10,341.1	674.3	9,246.1	420.6	9,666.7	9,666.7	9,666.7
Turkey	451.8	191.5	260.3	..	260.3	117.3	143.0
Total Central Powers	15,182.3	2,073.8	12,627.9	420.6	13,048.5	420.6	12,627.9
Grand Total	56,085.9	8,376.6	42,854.1	4,861.3	47,715.4	4,875.3	42,840.1

Adapted from *Inter-allied Debts*, by H. E. Fish, Bankers' Trust Company, N.Y., 1924.

TABLE XXVI
NATIONAL WEALTH OF THE CHIEF COUNTRIES

Country.	Year.	National Wealth.	In Sterling at Par.	In Sterling at Current Rate of Exchange.	Current Rate of Exchange.
Great Britain	1923	£20,000 millions	..	£20,000 millions	..
Canada	1923	\$25,000 ,	£5,100 millions	£5,400 ,	4 465 \$ = 1 £
India	1922	Rs.15,000 crores	£10,000 ,	£10,000 ,	15 Rs. to the £
The U.S.A.	1923	\$355,000 millions	£72,900 ,	£81,200 ,	4 37 \$ to the £
France	1923	Fr.1,200,000 millions	£47,600 ,	£14,400 ,	82.88 Fr. to the £
Italy	1923	L.611,000 ,	£24,222 ,	£6,100 ,	100 15/32 L. = 1 £

INDEX

- Abacus, 943
Abatements, British income tax and, 442, 444-45, 488-90; graduation by, 484; Indian income tax and, 465-66; on insurance premiums, 491; principles of, 491
Ability, or faculty theory of, subjective and objective, as measure of taxation, 305-6, 309
Absolute taxable capacity, definition of, 228; examples of, 227; in Great Britain, 252; of British India, 253; percentage of, in Great Britain and India, 254
Absorption theory of incidence same as diffusion theory, 345-48
Abul Fazl, 411
Accountant and Comptroller-General of Customs and Excise, 1026
Accountant-General, 81, 961; preparation of two budgets by, 962
Accounting Office, establishment of, 1021; powers of, 1022
Accounting Officer, duties of, 1039
Accounts, advantages of double entry system of, 1036; appropriation, 1038; audit of, 1045; costing system of, 1037; essentials of classification of, 1037; main objects of, 1037-38; method of keeping, in France and other countries, 95, 1037
Accruals, system of accounting by, 967
Ackworth Committee, arguments of, for and against State management of railways, 725-26; on management of Indian railways, 140-41, 725-26. *See also Railways*
Adam, the carpenter, 945
Adams, H. C., classification of public expenditure by, 87-88; classification of public revenue by, 205-6; on accruals, 967; on corporation tax, 594; on deficiency bills, 971; on meeting war expenditure, 790, 908; on mines, 716; on post-office, 720; place of his work in financial literature, 30
Adams, John, President, cited, 715; veto power and, 1013
Adams, John Quincy, President, veto power and, 1013
Addington, Lord, introduction of schedules of income tax in Great Britain by, 442
Administration, advantages of centralised, 149; civil, cost of, 100-101; cost of collecting direct and indirect taxes is to be included under, 101; expenditure in India on, 1076-77; general, expenditure in India on, 1076-77. *See also Financial Administration*
Administrative audit, advantages of, 1048
Administrative control, 1016; scope of, 1041
Admission, tax on, 687
Ad valorem duties, advantages and disadvantages of, 627, 630; definition of, 627; difficulty of valuation for, 627; distinguished from specific duty, 627, 629; successful operation of, in India, 628
Agent-General for Reparations, 840
Aggregate sacrifice, as theory in the distribution of the burden of taxation, 307-9; distribution of taxation and, 308; factors underlying, 309; incomes and, 308
Agricultural estate, death duties and, 529-30
Agricultural income, of British India, 242-48; taxation of, 405
Agricultural land, taxation of, 242-46
Agricultural profits, taxation of, 406
Agricultural property, death duties and, 529

- Agriculturalists and protective duties, 623-24
- Ahmedabad, 156 ; hoards in, 783
- Akbar, land revenue administration of, 410
- Alabama, quadrennial period in, 964 ; repudiation in, 788
- Alcavala, equivalent of sales tax in Spain, 608
- Alcázar de Arriaga, who propounded the single Alcavala, 331
- Alcoholic drink, duties on, 657
- Alexander the Great, plundering by, 783
- Algeria, Bank of, advances by the, 921
- Allen, Ralph, of Bath, development of cross-country posts by, 719
- Allied and Associated Powers, cost of War, 1106
- Allix, contribution to public finance by, 35
- Allowances, income tax and family, 444-45, 488-90 ; equal sacrifice and, 306
- Amortisation, theory of, 337
- Amusement tax, 284, 684-87
- Andréadès, contribution to public finance, 39
- Andreæ, contribution to public finance, 34
- Angell, Norman, on German depression, 837
- Annual land tax, 398
- Annual rental, as basis of land taxation, 743-44
- Annuities, borrowing upon, 774 ; method of repaying debt, 852
- Anson, on absence of regular statement, 950 ; on initiation of money grants by Commons, 1007 ; on royal warrant, 1013 ; on standing order, 979
- Apportioned tax, 390, 427
- Appropriation accounts, 1038
- Appropriation Act, 983 ; absence of, in India, 963, 992 ; presentation and procedure regarding, 985-86 and note
- Appropriation audit, 942, 1047
- Appropriation Committee in U.S.A., 998, 1000 ; First, 1047
- Appropriation Report, 1044
- Arabic numerals, 943 and note
- Area of various countries, 1071
- Argentine, public debt of, 1098
- Aristotle, cited, 25 ; contribution to public finance, 15 ; on electorate, 114
- Armaments, expenditure for the maintenance of, 97
- Army, abolition of purchase of commissions in, 1013
- Arthur, President, veto power and, 1013
- Asquith, Mr., Budget of 1907 and, 124
- Assam, land revenue settlement in, 414 : poll tax in, 587
- Assessment, British income tax, basis of, 497 ; collection of, 454-57 ; methods of, 498-500 ; money income and, 480 ; principles of, 498-500 ; schedules of, 490-91 ; Indian income tax and, 465-66 ; and land revenue in temporary settlement, 413-14 ; rates of, 414
- Assessment, special, compared with fees, 203, 261 ; Seligman on the characteristics of, 203 ; source of local revenue, 743
- Assessment, Triple, 439, 440, 477, 484, 523, 589
- Assignats, 913 ; history of, 916-17 ; statistics showing the history of French, 914
- Association, National Tax, 431, 548, 595, 598
- Astor, John Jacob, cited, 591
- Athens, 14 ; hoards in, 783
- Atticus, Herodes, cited, 784
- Audit, definition of, 4-5, 1016, 1045 ; early history and growth of, 1045-47 ; in U.S.A., 1021-22 ; objects of, 1048 ; report, 1048
- Audit Board, 1018, 1047
- Auditor-General, essentials of an ideal, 1049 ; functions of, 1048 ; importance of, 1049
- Augustus, on inheritance tax, 523 ; on land tax, 396 ; on sales tax, 607
- Aurangzeb, system of land revenue settlement under, 410
- Australasia, land tax in, 400
- Australia, alienation in, 401 ; amusement tax in, 684-87 ; central bank, State-owned, 1056 ; Commonwealth of, area, population, etc., 1071 ; and States debts, 932 ; conversion of internal debt in, 933 ; cost of War, 1106 ; customs duties in, 638-39 ; death duties in, 564-65 ; direct and indirect taxa-

- tion in, 1097; distribution of revenue in, 266-67; excess profits tax in, 603; excise duty in, 660; income tax in, 459-60; land tax in, 400-401; large amount of foreign loan in, 931; loan council in, operation of, 153, 267, 293, 931, 932; old age pensions in, 124; posts, telegraphs, telephones in, revenue from, 721; powers of chambers in, 1009; proportion of expenditure to national income in, 1083; public debt in: analysis of, 1102, Commonwealth and States, 932, growth of, 1098, history of, 930-33, *per capita*, 931, ratio of, to revenue, 1103, services, 1104, unproductiveness of, 931; railways in, fiscal results of, 723; reduction in government expenditure in, 932; sales tax in, 671; taxable capacity in, 257, taxation, and national income, 1095, before and after the War, 1090, *per capita*, 1091; taxation of land values in, 401; veto power in, 1012; South: taxation of unimproved land values in, 401
- Austria, area, population, etc., 1071; capital levy in, 869; cost of War in, 1106; land tax in, 407; loan received by, 824; octroi in, 670, public debt of: growth of, 1098, services, 1104, ratio of, to revenue, 1103
- Authorities, customs, duties of, 631-32
- Authorities, Public, definition of, 3
- Auxiliary Committee on the need of primary education in India, 109
- Avebury, Lord, diffusion theory of taxation, 335, 345
- Bachelors, income tax and, 306, 474
- Bacon, cited, 59, 535, 584
- Bagdad, 784
- Bagehot, Adam Smith, characterised as one of the most unbusiness-like of men, 25; on ministerial responsibility for money bills, 1001-1003
- Bahamas, fees in, 577
- Balfour Note, connexion between reparations and War debts by, 831, 835
- Bank, Central. *See* Central Bank
- Bank credits, causes for the recourse to, 795; effects of creating, 795, 798; finance by, 794; general conclusions regarding, 795; inferiority to taxation, 795; poorer classes and, 795
- Bank of Algeria, advances by, 921-22
- Bank of England, as authority for management of currency, 1051; consultation and co-operation between, and the Treasury, 1054-1055; credit control by, 1061; day-to-day policy of, 1062; Deputy-Governor of, on Government and, 1055; duty of receiving public money by, 1020, 1025; foreign exchange and, 1063; Governor of, on State interference, 1056; Governor and Deputy-Governor of, are *ex-officio* members, 1052; importance of, as a central bank, 1051-52; joint-stock banks and, 1061; keeping of public moneys by, 1029; management of monetary system by, means of, 1062-63; open-market transactions of, 1062; origin of public debt, by the advances of, 884; part played by, in spending public moneys, 1031-1035; restrictions on, 1060 note
- Bank of France, advances by, 921-22; as a central bank, 1051; disadvantages resulted in 1923 and 1925 by State interference, 1056; Napoleon on, 1029
- Bank of International Settlements, advantages of, 1067-68; difficulties of, 1067-68; functions of, 1066; object of the creation of, 1066; origin of, 1066; limitations on, 1055, 1067-68
- Bank rate, a method of controlling credit, 1061
- Barbados, estate duty in, levied by the Estate Duty and Absentees Act of 1895, 577
- Barnes, 958
- Bastable, economics and finance, 7; on capital and revenue expenditure, 160-61; on classification of public revenue, 205; on direct and indirect tax, 209; on non-economic expenditure from income, 160; on proportional taxation, 309; place of his work in financial literature, 29

- Baxter, Dudley, classification of countries by, 775
- Bearer bonds, incidence of duty on, 676
- Beaumont, D'Eon De, cited, 24
- Beaumont, Moreau De, Adam Smith's indebtedness to, 214
- Beccaria, cited, 77
- Belet, Michael, audit by, 1045
- Belgium, area, population, etc., 1071; cost of War, 1106; debt in: analysis of, 1102, expenditure on, services, 1104, growth of, 1098, ratio to revenue, 1103; extraordinary budgets in, 972; octroi in, 672; sales tax in, 618; succession duty in, 522
- Beneficial rates, 734
- Beneficiaries, tax on, 524
- Benefit, as canon of expenditure, 77-78; as measure of taxation, 304
- Bengal, amusement tax in, 685; land revenue settlement in, 412, 419
- Bentham, phraseology of, in the theory of least aggregate sacrifice, 308
- Bentham, Jeremy, cited, 680
- Berlin, municipal constitution of, 764
- Bermondsey, 120
- Bernier, cited, 567
- Bernouilli, law of utility diminishing in inverse ratio to means, 307
- Betting, taxation of, 210, 673, 680-84
- Bicameral legislature in India, 993
- Bigge, Sir Amherst Selby, on the English board of education, 109
- Bihar and Orissa, land revenue settlement in, 412, 414, 419
- Bismarck and the budget, 1014
- Board, National Industrial Conference, 31; of audit, 1018, abolition of, 1047; of customs and excise (Australia) and betting tax, 682-683, 952; of Governors of the Federal Reserve, 1052 note, 1058 note; of Inland Revenue and Rignano's scheme, 549, on capital levy, 865, presentation of estimates by, 952
- Bodin, cited, 15
- Boisguilbert, contribution to public finance, 16, 17
- Bombay, agricultural wages and the value of agricultural products in, 407-9; amusement tax in, 685; entertainment tax in, 271; land revenue settlement of, 413, 416; selling mortgage and letting value of land in *talukas* of, 418
- Bonar, cited, 23
- Bonds, definition of, 774; tax on, 283
- Bonus shares, tax on, 481, 483
- Booth, Charles, on old age pensions, 132
- Borah, Baharaj, cited, 783
- Borrowing, limits of, 787; peculiarities of, 787-89; restrictions on, 11, 204; theory of governmental, 159. *See also Debt and Public Debt*
- Bougette*, 940. *See Budget*
- Bounties, 357, import duties and, 624-25
- Bowley, estimates of national income by, 239, 242, 700; method of calculating national income, 237-238
- Brazil, growth of debt in, 1098
- Brougham, Lord, on education, 114
- Bruins, Professor, on double taxation, 321
- Brussels Financial Conference, on the creation of a central bank, 1059; on the distinction between productive and unproductive expenditures, 189; on the government, 187
- Bryce, Lord, on Henry Sidgwick, 536; on veto in U.S.A., 1013
- Buccleuch, Duke of, and Adam Smith, 19
- Buchanan, President, veto power and, 1013
- Budget, annual voting of the whole, 1004; characteristics of a, 968-969; contents of, 968; definition of, 937-38, 939-40; director of, in U.S.A., 957, 1000; early adoption of the term, 937; effects of the monsoon on, 962; execution of the, 1016; extraordinary, 972-73; facts that cannot be shown by a, 940; Ginnawa's criticism on Indian, 6; legalisation or voting of the, 975, in the Dominions, 990, in France, 995-96, in Germany, 996-98, in Great Britain, 977-89, in India, 990-95, in the United States, 998-1001; minister of, in France, 952; opening of, 984; preparation of, 951, in France, 952, in Germany, 954-55, in Great

- Britain, 951-52; in India, 960-64; in the United States, 955-60; publications of, in various countries, 975-76; reappropriations in, 1009-11; refusal to vote, 1012-13; requisites of, 968-69; scrutiny of, 11-12, 765; separation of railway, 725-26, 729-31; supplementary, 969-71
- Building land, taxation of, 738
- Building rent, incidence of a tax on, 367-68
- Bulgaria, area, population, etc., 1071; central bank in, State-owned, 1056; cost of War, 1106; debt, growth of, 1098; land tax in, 407
- Burden of taxation. *See* Taxation
- Bureau of the Budget in U.S.A., 957
- Buren, Van, President, veto power and, 1013
- Burke, on independence of Parliament, 1017-18
- Burma, betting tax in, 685; poll tax in, 586-87
- Business tax, 607, 750, 1097
- Business Undertaking by Government, expenditure on, 1076-77; revenue from, 1086-87
- Buxton, Sydney, on postal system, 719
- Cadastre, 390; in India, 416
- Calendar year, in regard to budget, 965
- California, budgetary procedure in, 956
- Cambon, consolidation of French debt by, 916
- Camouflaged loans, 913
- Canada, amusement tax in, 685; central bank in, 1051; characteristics of revenue distribution in, 265-66; corporation tax in, 593; cost of War, 1106; customs duty in, 636-38; debt: analysis of, 1102; expenditure on, services, 1104; growth of, 1098; ratio to revenue, 1103; distribution of public revenue and sources of revenue for federal and provincial governments, 263-64; dominion: area, population, etc., 1071; excise tariff in, 660; expenditure for education in, 110; expenditure and national income, 1093; income tax in, 458-59; inheritance tax in, 563; land tax in, 403; posts, telegraphs, and telephones, revenue from, 723; powers of the two chambers in, 929; preferential and reciprocal tariff in, 637; protective tariff in, 637; railways in, fiscal results of, 725; sales tax in, 618; taxation and national income, 1094, before and after the War, 1090, direct and indirect, 1097, *per capita*, 1091; veto in, 1012; voting of the budget in, 990; wealth in, 1107; Western, tax on unimproved land values, 403
- Canals, keeping of, 722; length of, in England and Scotland, 722; revenue from, 722
- Canard, diffusion theory of incidence, 346
- Cannan, Professor, canons of taxation, 213-14
- Canons, of public expenditure, 77-82; of taxation, 213-25
- Capacity, taxable. *See* Taxable Capacity
- Cape Colony, succession duty in, 566
- Capital, estate duty and, 538; income tax and, 538; of central banks, 1056; taxation of: 372, 534, 852, 864, arguments against, 535-41, development of, in twentieth century, 536, incidence of, 372-73
- Capital expenditure, 159; effects of double taxation to, 318-19; justifications of, 162-68; objections to, 874; principles governing, 185-86; reasons for the increase of, 178-81
- Capital gains, tax on, 481
- Capital levy, 1097; absence of a proper distribution of the burden of, 875; arguments: for, 866 note, 867-75, against, 866-75; as method of repaying debt, 852; difficulties of administrative technique of a: (1) absence of a fair measure of assent, (2) difficulty of a guarantee against the repetition of a levy, (3) hostility on the part of bankers, and (4) lowering exemptions, 876-77; effects of, on capital and credit, 873-74; essentials of, 864; inferiority of, to income tax, 870; in various countries, 869-73; objections to, 873; opportunity for such a, 876; rates of, 867

- Capitalisation, theory of, 337
 Capitation taxes. *See* Poll taxes
 Carafa, cited, 15
 Carlisle, Bishop of, audit by, 1045
 Carlyle, "books accomplish miracles", 24
 Carteret, subsidies and, 829
 Carver, minimum regression as a principle of taxation, 307
 Castells, William de, audit by, 1045
 Centani, a Spaniard, ancestor of Physiocrats, 331
 Central Bank, advances by, to State, 1056; advantages of a, 1059; advantages of a centralised system of, 1065 note; Brussels International Financial Conference of 1920 on the creation of, 1959; capital of, 1056; closeness and cordiality between Government and, 1054-55; control of credit by, 1060; dangers in nationalisation of, 1057 note; difficulties to be faced by, 1063; disadvantages resulting from the absence of, 1064; discount policy of, 1060-61; dividends of, limitation to, 1059; foreign assets and exchange of, 1059; Genoa International Financial Conference of 1922 on the creation of, 1059; importance of, 1066; independence of, 1054; method of achieving independence, 1056; interference by State, disadvantages resulting from, 1055; investment of, 1059; limitations of, 1055, 1059; management of, 1058 note; member banks and, 1061; method of regulating price level, 1063; necessity of a managed monetary system, 1065; open market, transactions of, 1060; effects of, 1060-61; powers of, 1064; reserves of, 1066; right of note issue, 1060; scope and functions of, 1058-60
 Central Powers, cost of War to, 1106
 Central and provincial taxation in India, 1096
 Centralised control, advantages of, 879
 Centralised system of government, advantages of, 149
 Certainty, as a canon of taxation, 218-20
 Certification, 1012
 Ceylon, estate duty in, 576-77
 Chamberlain, Mr., on old age pensions, 132
 Chambers, powers of, 1007
 Chance loans, 779
 Chancellor of the Exchequer, functions of, in regard to budget, 949, 952, 984; other titles of, 948
 Chancellor of the Reich, 954
 Chandavarkar, The Hon. Sir Narayan, on votable and non-votable items, 1005-6
 Charles I. on veto, 1013
 Chaucer, cited, 245
 Cheques, incidence of duty on, 677
 Chicago, property tax in, 740-41
 Childers, Mr., conversion by, 897
 Chile, area, population, etc., 1071; public debt of, 1097
 China, central bank in, 1051; debt in, 1098; excise in, 668-69; land tax in, 422, main defects of, 424-425
 Churchill, Lord Randolph, on estate duty, 525
 Cicero, cited, 5
 Cigarettes, tax on, 661
 Civil Administration, cost of, 100-101
 Civil Contingencies Fund, advantages of, 1011; definition of, 1011; similarity of, to Treasury Chest Fund, 1011
 Civil estimates, 1001
 Civil list, 47, 65, 951
 Civil service, 50, 60, 65, 91, 98, 101, 975, 981-83
 Cleanliness, tax on, 659
 Clerk of the Issues, 1032
 Clerk of the Pells, abolition of, 944, 1018
 Cleveland, President, veto power and, 1013
 Coal mines, 715-16
 Cobden, cited, 58
 Cohn, classification of public expenditure by, 85; contributions to public finance, 32, 33; criticism on Smithian canons of taxation by, 213
 Colbert, on finance, 5
 Collection of taxes, cost of, British India, 1076-77
 Colombia, central bank in, 1056
 Colorado, State University and Agricultural College in, 111

- Colson, contribution to public finance, 35
- Colwyn Committee. *See* Committee on National Debt and Taxation
- Colwyn Report, classification of public expenditure by, 84 ; on the effects of public expenditure, 75
- Commercial accounting, 939
- Commercial activities of the State, 715
- Commercial debts, 776 ; difference between War debts and, 824 ; effects of fall in prices on, 826
- Commercial documents, tax on, 679
- Commercial undertakings by State, 140-43
- Commission : Dawes, 831
Funding Debt, 831 note ; on capacity to pay, 833
- Indian Fiscal, on tariff, 629, 641
- Inter-State Commerce, on railways, 728-29
- Reparations, 837-40
- Royal, on assessment, 500 ; on double taxation, 321-25 ; on graduation, 484, 487 ; on importance of collection at the source, 496 ; on income tax, 446, 484, 486
- Commissioners : of Customs and Excise, 947
- Inland Revenue, 947
- Public Accounts, on the establishment of a common fund, 941 ; on the formation of a sinking fund, 887
- Committee : Aeworth, arguments of, for and against State management of railways, 725-26 ; on management of Indian railways, 140-42, 725-26. *See also* Railways
- Basle, Report of, 842-43
- Dawes, 824 ; works done by, 839-841, 846
- Estimates, 989
- Finance, 321-24, 994, 1044-45
- Geddes (Great Britain), on national expenditure, 5, 1043 ; criticism by, on the percentage grants, 745-746 ; examples of retrenchment, 71-72 ; on extent of beneficial work of the State, 74-75 ; on reduction of, expenditure for defence, 97-98 ; recommendation relating to statistics and prison labour, 62-63 ; terms of reference, 59
- Committee—*continued.*
Inchcape (India), 5 ; examples of economy, 62-63 ; on expenditure, 98 ; terms of reference, 59
- Joint Select (India), on Great Britain and India, 625-26 ; on safeguards, 964-65
- Macmillan, on Finance and Industry, 1054 ; on the managed system of the Bank of England, 1065
- May (Great Britain), 5, 1043 ; on expenditure chargeable to capital, 178 ; terms of reference, 59
- Of Experts, on the burden of taxation, 691
- Of Supply, duties of, 981 ; powers of, 982
- Of Ways and Means, 981 ; functions of, 984
- On Currency and Foreign Exchange, on the policy of inflation in Great Britain, 796-98
- On National Expenditure, and Rignano plan, 550 ; on capital levy, 866, 877-78 ; on conveyance duty, 676-77 ; on dangers of floating debt, 799 ; on distinction between shifting and incidence of a tax, 336-37 ; on double taxation, 319, 692-94 ; on incidence of a tax on monopolist, 356 ; on incidence of death duties, 386 ; on principles for expenditure on economic development, 144-45 ; on sinking fund, 857 ; terms of reference, 865
- Public Accounts, 1021 ; legislative control by, 1042
- Select (Great Britain) on taxation of 1906, 444, on graduation, 484 ; suggestions of the, 989
- Taxation (India), on the burden of taxation, 691
- Transfer, 839
- Commodities, conditions and effects of incidence of a tax on, 351-53
- Common benefit in public expenditure, 86
- Commons, House of, on budget estimates, 968 ; powers of, 1007
- Companies, tax on, 481. *See* Corporation
- Company, East India, criticism of the administrative function of, by Adam Smith, 73, 710-11 ; decision

- of permanent settlement by, 412 ; thirty years period of settlement introduced in Bombay by, 413
- Company, South Sea, advances by, 884-85, 896
- Comptroller and Auditor-General, duties of, as prescribed by the American Budget and Accounting Act, 1021-22 ; his functions, 65, 942, 946, 1048 ; part played by, in spending, 1031-35 ; powers of, 983
- Comptroller and Auditor-General of the Post Office, 1040
- Comptroller-General, 1021
- Conference : Brussels Financial, on the creation of a central bank, 1058 ; on the distinction between productive and unproductive expenditures, 189 ; on the government, 187
- Genoa International Financial, on the creation of a central bank, 1058
- Hythe, cited, 835, 846
- International Shipping, on double taxation, 315-16
- Confirmatio Cartarum, 977
- Congleton, Lord. *See under Parnell*
- Comigliani, contribution to public finance, 36, 37
- Conjuncture gains, taxation of, 312
- Consolidated Act, 983
- Consolidated bills, 983
- Consolidated Fund, establishment of, 941 note, 942, 983
- Consolidated Fund Services, 981-82
- Consols, 819
- Consumption, Internal taxes on. *See under Excise*
- taxes on, 588-90, regressiveness of, 654
- Control, three kinds of, 1016
- Control over issue, 1038-45
- Contrôleurs in France, 953
- Convenience, as a canon of taxation, 220-21 ; indirect taxes and the canon of, 221 ; justification of the canon of, 220-21
- Convention, Draft, in regard to double taxation, 327-29
- Conversion, definition of, 859 ; history of, under various chancellors in Great Britain, 895-98 ; importance of, since the War, 898-
- 899 ; method of repaying debt, 852 ; of Great Britain, 860-61 ; principles of, 859, absence of, in various countries, 860 ; table showing the cost of interest and management of national debt, 900 ; table showing the successful, 900
- Conveyance duty, 676
- Coolidge, President, veto power and, 1012
- Cornwallis, Lord, initiation of permanent settlement in India by, 411
- Corporation, compared with Government, 938-39
- Corporation tax, 482-83 ; basis of assessment, 595 ; in Great Britain, 596, 1097, in U.S.A., 597-98 ; statistics of, in various countries, 592, 593-94
- Corporations, privileges of, 594
- Corvée*, as a tax, 22
- Cossa, contribution to public finance, 36, 37
- Cost accounting, 939
- Cost of administration, 100-101
- Cost of living, index numbers of, 1090
- Cost of service, as measure of distribution of tax, 304
- Cost of War, 1106
- Cotton excise duty in India, 664-65
- Coubron, cited, 23
- Council, Loan, in Australia, 153, 267, 293, 931, 932
- Council of ministers, 953, 954, 955
- Council of State, ruling on initiation of money bills, 1003
- Cour des Comptes*, on extraordinary budgets, 973 ; powers and functions of, 1043 ; Fisk on, 1042-43
- Cournot, contribution to public finance, 35
- Crassus, cited, 784
- Credit, control of, by a central bank, 1059 ; causes for the recourse to, 795 ; effects of creating, 795, 798 ; finance by bank, 794 ; general conclusions regarding, 795 ; inferiority to taxation, 795 ; poorer classes and, 795
- Cromwell, Thomas, cited, 949
- Crown Colonies, cost of War, 1106
- Crown lands, Great Britain, 1084
- Crown property, 399
- Ctesiphon, hoards in, 784

- Cunningham, Timothy, contribution to public finance, 23; on Adam Smith's maxims of taxation, 214
- Custody of public moneys, 1028; in France, 1029; in Great Britain, 1029; in India, 1028; in U.S.A., 1029
- Customs Duties, abolition of, by Peel, 299; characteristics of, 651; early history of, 620; forms of, 627-30; general economic considerations concerning, 620, in England, 631-36, 1089, 1097; in France, 645, 1097; in India, 641-645, 1090, 1097; in Italy, 1097; in Japan, 648, 1097; in other countries, 645; in the Dominions: Australia, 638, 1097, Canada, 637, 1097, New Zealand, 639, South Africa, 640, 1097; percentage of, to total, 626; practical statesmen and, 650; productiveness and, 651; twofold objects of, 649
- Czechoslovakia, area, population, etc., 1071; capital levy in, 869; central bank: limitations in regard to advance to state, 1055, state capital and, 1056; debt in, 1098; land tax in, 407
- Dadabhoi Naoroji, Mr., estimate of *per capita* income of British India by, 243, 254
- Dalton, on capital levy, 872; on transfers of wealth, 815
- Davenant, contribution to public finance, 15
- Davidson, cited, 417
- Dawes, Charles, cited, 839
- Dawes Committee, 834, 846; works done by, 839-41
- Dawes Loan, 810-11; services of, 853-54
- Dayabhaga, cited, 571
- Deadweight debt, definition of, 774
- Death duties, and insurance, for the payment of, 437 note; as complement to income tax, 487, 527, 537; capital and, 535-41, 537; disadvantages of, 530; effects of, 530-31, on saving, and enterprise, 542-44; equity of, 526; ethical superiority of, 538; incidence of, 386; in Federal constitutions, 552; in France, 579-80; in Germany, 580; in Great Britain, 556-63; in Holland, 581; in India, 567-76; in Italy, 580-81; in Japan, 581; in Spain, 581; in Switzerland, 581; in the Crown colonies, 576-77; in the Dominions: Australia, 564-65, Canada, 563-64, New Zealand, 565-66, South Africa, 566-67; in the U.S.A., 577-79; percentage of, to total in Great Britain, 557; proceeds of, should be spent on capital expenditure, 541, proceeds of and debt redemption, 539; proceeds of and state spending, 539
- Debt, analysis of, 1102; as a main division of the study, 4; external, 1102; floating, dangers of, 799; definition and scope of, 774; funded, 1102; growth of, in India, 1100-1101, in other countries, 1098; internal, 1102; ratio to revenue, 1103; services: as a primary expenditure, 102, expenditure on, in, all countries, 1104; in India, 1076-77, reasons for the increase of, 102-5; unfunded, 1102. *See under Public Debt*
- Debt, conversion of. *See under Conversion*
- Debt, redemption of. *See under Redemption*
- Decentralised system of government, advantages of, 149
- Decker, Sir Matthew, contribution to public finance, 23
- Deductive method, meaning of, 9
- Defence, central subject, 148-50; cost of, 90-91, 96-99; expenditure on, in India, 1076-77
- Deficiency bills, Adams on, 971; in the U.S.A., 965
- Deficit, avoidance of, in budget, 82
- Degree of progression, 299, 311, 312
- Degree of regression, 294
- Degressive taxation, definition of, 294
- Delphi, hoards in, 783
- Demand, elasticity of, burden taxation and, 689; commodity taxes and, 352; luxury taxes and, 615; protective duties and, 623-24

- Denmark, area, population, etc., in, 1071; debt: analysis of, 1102, growth of, 1098, ratio to revenue, 1103
- De Parieu, cited, 309
- Dependents, allowance for, 488
- Derivative revenue, 206
- Detailed veto, definition of, 980
- De Viti de Marco, contribution to public finance, 36
- Dickens, Charles, on the burning of the two Houses of Parliament, 1020
- Dietzel, cited, 818; on meeting all extraordinary expenditure from loans, 159
- Differential taxation, least aggregate sacrifice and, 307
- Differentiation, deduction of earned increment in Great Britain for, 486; expression used in different countries to indicate distinction between earned and unearned income, 487; objections to the term unearned increment by the Royal Commission of 1920, 487
- Diffusion, or absorption theory of incidence, 345; characteristics of, 347; Canardon on, 346; Seligman on, 346
- Diminishing return, law of, 356, 361
- Diminishing Utility, 486, equality of sacrifice theory and, 218
- Dingley tariff in U.S.A., 646
- Diocletian, reorganisation of land revenue by, 397
- Direct tax, advantages and disadvantages of, 301-2; all countries, 1097; characteristics and effects of, 301-2; definition of, 207-9; Gladstone on, 297-98; Great Britain and, 1084; India and, 1086-87; percentage of, to total tax revenue, 295; ratio between indirect and, 296; relation between indirect and, 296
- Disraeli, reduction of income tax rates by, 443
- Distribution of expenditure, in India, 1076-77
- Distribution of revenue in Great Britain, 1084, in India, 1086-87
- Distribution of tax and aggregate sacrifice, 308; of burden, 294-334
- Distribution, theories of just: (1) cost of service, objection, 304; (2) benefit, objection, 304-5; and (3) ability or faculty, 304-5
- Dividends, tax on, 863; limitation of, of central banks, 1059
- Doctor, tax on, 590
- Documents, duties on, 679
- Dog tax, 439, 588, 590, 737
- Domain, 206, basis of public revenue in early times, 712; gradual diminution of, land as source of revenue, 713; in commerce and industry, 715-21; revenue from, 715; revenue from State, in France, Great Britain, India, Italy, Russia, and Spain, 713-14
- Domestic debts, 771; for economic development, 811
- Donations, examples of conscience money in Great Britain and conscience fund in U.S.A., 204
- Double Taxation, agreements between two taxing countries of the same object according to origin and residence, 314-16, 319; as economic barrier between countries, 316-17; companies and, 317; definition of, 314; difficulties in avoiding, 316; effects of, on capital, 317; income tax personal and, 319; methods of avoiding, 321-30; relief in, by taxing the articles according to *situs* and residence, 329-30
- Dove, cited, 332
- Dowell, contribution to public finance, 29
- Drugs, tax on, in India, 663 note
- Dupont de Nemours, contribution to public finance, 22
- Dutiable instruments, three groups of, 675
- Duties, Customs. *See* Customs duties
- Duties, Death. *See* Death duties
- Estate. *See* Estate duties
- Export. *See* Export duties
- Imports. *See* Imports duties
- Legacy. *See* Legacy duties
- Specific. *See* Specific duties
- Stamp. *See* Stamp duties
- Succession. *See* Succession duties
- Dutot, contribution to public finance, 23
- Duverney, contribution to public finance, 23

- Earned income, deduction of, to arrive at the assessable income, 487 ; distinguished from unearned income by the Finance Act of 1907 of Great Britain, 444, 548 ; objections to its differentiation from unearned income, 484
- East India Company, criticism of the administrative function of, by Adam Smith, 73, 710-11 ; decision of permanent settlement by, 412 ; thirty years period of settlement introduced in Bombay by, 413
- Ecclesiastical department, expenditure on, in India, 1076-77
- Economic rent often mixed up with other forms of income, 365
- Economics, relation with public finance, 7-8
- Economy, as canon of expenditure, 79-80 ; as canon of taxation, 221-223
- Economy and retrenchment, committee on national expenditure in Great Britain and the Indian Retrenchment committee on, terms of reference, 59 ; meaning of the terms, 60 ; principles in regard to the necessity of, 59-60 ; various measures of check in, 69-70
- Edgeworth, cited, 303 ; doctrine of minimum sacrifice, 307-9 ; on incidence of rates, 370
- Education, control of primary and secondary, in Scotland, 115-16 ; expenditure on, 108 ; in India, 1076-77 ; justification of, 112-13 ; importance of, 107 ; in England, Wales, and Scotland, legislation for, 107-8 ; in the Dominions, Australia, Canada, and South Africa, 109-11 ; in the U.S.A., 111-12 ; *per capita* expenditure for, 115 ; percentage of literacy in England and Wales, 113 ; in India, 109, 113 ; percentage of illiteracy, 107 ; primary, want of, 109 ; revenue from, in India, 1086-87
- Egypt, absence of real audit in, 1049-1050 ; debt of, 1098 ; octroi in, 672
- Eheberg, contribution to public finance, 32
- Einaudi, contribution to public finance, 36, 205 ; on abatements, 488 ; on double taxation, 321 ; on sale of lands, 391
- Elasticity, as a characteristic of a good revenue system, 197-98
- Elasticity of Demand, burden of taxation and, 689 ; commodity taxes and, 352 ; luxury taxes and, 615 ; protective duties and, 623-24
- Ely, Richard T., against the doctrine of *laissez-faire*, 58 ; on expenditure from the proceeds of death duties, 540
- Emerson's phrase for a finance minister, 950
- Enterprise, advantages of State, 711-712
- Enterprise, Saving and, effects of death duties on, 542-44
- Entertainments, tax on, 686, 1097 ; definition of, 686 ; exemptions of, for philanthropic purposes, 686 ; problem whether it is permanent or temporary, 685 ; progressive rates of, 686 ; revenue from, 686
- Equality, or Equity, as a canon of taxation, 215-18
- Equality of Sacrifice, as a theory in the distribution of the burden of taxation, 306-7 ; bachelor and married man and, 306 ; difficulty in taking, theory as an ultimate theory, 306 ; J. S. Mill on, 305 ; quantitative aspect of income and, 306 ; windfalls and, 306
- Estate, agricultural, 529, 530
- Estate duty, 523, 524 ; advantages of, 529-30 ; capital and, 538 ; definition of, 537 ; exemptions of, in Great Britain, 560 ; graduation of, 525 ; immovable and movable property and, 560 ; in Great Britain, 1084, in other countries, 1097 ; one of the two sources from which death duties in Great Britain are collected, 556 ; rates of, in Great Britain, 533, 561-62 ; statistics showing the burden of, in Great Britain, 530. *See* Death duties
- Estates General, 995
- Estimates Committee, 989
- Estimates, Supplementary, Adams on, 971 ; Gladstone on, 189, 971 ; May on, 970

- Evasion, 337; cases of, in Great Britain and India, 501-4; causes for, 507-8
- Evasion of taxation on income, 501; Pareto's Law and, 508-18
- Evelyn, Fox's friend, 1019
- Excess Mineral Rights Duty, as a complementary to Excess Profits Duty, 602
- Excess profits tax, charge on profit above a standard rate of trading concerns and not on individuals, 598; effects of, and objections to, 600; history of, in some countries, 599; in Great Britain, 1084; standards of exceptions to, 601-2; in India, 603; in New Zealand, 602-3; in other countries, 1097; in the state of Georgia during the American Civil War, 599; in the United States of America, 603-4; suitable to special taxation, 312
- Exchange, receipts from, 1036-87
- Exchequer, 941 note; abolition of the old office of, 944-45; account at the Bank of England, 1025 note; as court of audit, 1045; as court of law and administrative department in Edward I.'s time, 944; causes for the confusion in regard to functions of Treasury and, 947-48; definition of, 943 note; duties of, 946; robberies of, 945-46
- Exchequer bills, 884
- Exchequer, Chancellor of the, functions in regard to budget, 949, 952, 984; other titles of, 948
- Excise, articles suitable for duty in various countries, 652; as indirect tax, 198; characteristics of, 657; definition of, 652; early history in Great Britain, 657-58; in China, 668; in France, 666-67, 1097; in Germany, 668; in Great Britain, 657-60, 1084, 1097; in India, 662, 1036-87, 1097; in Italy, 667-68, 1097; in Japan, 668, 669-70, 1097; in Spain, 668; in the Dominions: Australia, 660, 1097, Canada, 660, 1097, New Zealand, 660, Union of South Africa, 661-62, 1097; in the U.S.A., 1097; popularity of, after the War, 704; principles underlying, 653-54; reforms of Pitt, Huskisson, and Gladstone, 659; statistics showing percentage revenue of, to total revenue in various countries, 653
- Executive budget, 956
- Exemptions, justification of, in times of war to attract capital, 801
- Exhaustive expenditure, 89-90
- Expenditure, and national income, 1083; as a division of the study, 4; causes for the increase in public, 48-54; central and provincial governments in India, 1074, 1076-77; chargeable to capital, 159; distribution of, 1080; distribution of, between central, provincial, and local governments due to historical conditions, 148, 157-58; federal authority and, 158; general consideration in the distribution of, 153; growth of, allowing for prices, 1082; importance of, 46; increase in, in India, 1072-74, on social services in recent years, 135-38; in India, 1076-77; local government and, 1078-79; of various countries, 1071; on debt services, 1090; on defence, in various countries at the present time as compared with pre-War year, 97; on development and miscellaneous services, 139, two classes of development, 145-46; on education, 108; on other social services, 116; on religion, 118; on the primary functions of Government, 96; on the secondary functions of Government, 106; ordinary and extraordinary, 93-94; percentage of central, provincial, and local, in various countries, 150-54; percentage distribution of governmental, 189-190; productive and unproductive, 189-90; theory of public, 45; votable and non-votable, 1005. *See also* Public Expenditure
- Export duties, early history of, 621; effects and unpopularity of, 350, 621-22; incidence of, 362-63; revivals of, for protective and fiscal reasons after the Great War, 622; unpopularity of, 621

- External loan, 771; direct and indirect burden of, 811-13; for economic development, 811, 1102
- Extraordinary budgets, definition of, 972; evils of, 973; scope of, in various countries, 972
- Extraordinary expenditure, 93-94; definition and scope of, 187-88, 972-73
- Fabius, Cunctator, cited, 169
- Family allowance, income tax and, 472, 474, 489-90
- Family budgets, collected by the Labour Office, Bombay, 253
- Famine relief, 92, 123, 188; expenditure on, in India, 1076-77
- Fauquier, contribution to public finance, 24
- Federal Government, functions of, 292-93; sources of revenue to, 264-65, 267-69, 276, 279-80, 283
- Federal Reserve, Board of Governors of the, advantages of, 1052-53; powers of, 1052
- Federal Reserve Banks, 1051, 1052; duties done by, 1053; Government banker, 1053
- Fees, compared with price and tax, 202-3; definition of, 202; difficulty to distinguish from tax, 203, 673; judicial, commercial and other, 674
- Feudal aids, as a form of land tax, 397
- Fillmore, President, veto power and, 1013
- Finance Accounts, 941
- Finance Bill, 986
- Finance, Commissary of, in Russia, 1057
- Finance committee, 994; legislative control by, in India, 1044-45
- Finance, Local, control over, by an executive, 763-65; jurisdiction in, 766; necessity of a strong executive in, 765-66
- Finance Members of India, 1072-73
- Finance Minister, qualifications of a, 949-50
- Finance, Ministry of, in France, 952; in Germany, 954-55
- Finance, Public, French, German and Italian equivalents of the terms of, 4; history of, 13-41; meaning of, 3; main divisions of, 4; method of, 8-10; relation of economics and statistics to the science of, 7-8
- Finance, War-time, amount raised from internal, external, funded, and unfunded loans, 902-3; characteristics of (1) large amount of foreign loans, 903; (2) consols and war loan (table), 904-5; (3) continuous borrowing, 905; (4) system of tax compounding, 905; and (5) heaviness of the floating debt, 905; table showing, 901-2
- Financial administration, as a main division of the study, 4; scope of, 5; theory of, recent development, 13
- Financial assistance, in constitutional Acts, 288; in granting, responsibility of the central or Federal Government, 290; relation between Federal Government and units regarding, 290; responsibility of Federal Government regarding, 290-91
- Financial control, 939, 1042-45
- Financial Department, powers and duties of, 961, 1010, 1038
- Financial procedure. *See under Budget*
- Fines, 204
- Finland, abolition of land tax in, 389; debt of, 1098; State-owned central bank in, 1056
- Fiscal period, 966
- Fiscal year, causes for the selection of, 965-66; in various countries, 964-65
- Fisk, on judicial control, 1041-42
- Floating debt, definition and scope of, 773; dangers of, by Colwyn Committee, 799
- Florida, repudiation in, 788, 862 note
- Flux, estimate of national income by, 238
- Foldes, Béla, contribution to public finance, 34
- Forbonnais, contribution to public finance, 18, 23
- Forced loan, 777, 788, 802-3
- Fordney tariff in U.S.A., 647
- Foreign debts, 771; for economic development, 811
- Foreign income and British income tax, 478-79
- Foreign trade, control of, 621

- Foreigner, double taxation and, 316 ; export duty and, 621-22
- Forests, as a source of revenue, 696 ; in India, 1086-87 ; expenditure on, in India, 1076-77 ; in India, 714 ; policy of Russia concerning, 713
- Formulae regarding the distribution of revenue to local authorities, 747 ; absence of mathematical, for the administration of the Federal Reserve System or the regulation of prices, by Governor Strong, 1064
- "Four old women", 282, 284, 472
- Fox, on withholding subsidies, 1014
- Fox, C. J., cited, 1019
- Fox, Henry, cited, 1019
- Fox, Sir Stephen, cited, 1019
- France, advances received by, from the Banks of France and Algeria, 921-22 ; agricultural income tax in, 405 ; amusement tax in Paris, 284 ; annual voting of the budget in, 1004-5 ; area, population, etc., in, 1071 ; budget : legalisation of, 995-96, defects in, 996, powers of the two chambers, 1009, preparation of, 952-54, publications concerning, 976, verification of accounts, 1022-23 ; business turnover tax in, 284, 472 ; central bank in, 1051 ; central revenue heads in, prior to 1914, 282-83 ; changes between 1914 and 1920, 282-84 ; collection of revenue in, 1023 ; consolidating loans in, 920-21 ; consumption taxes in, 590 ; conversion in, 860, 917-18 ; cost of War, 1106 ; customs in, 645-46 ; debt : analysis of, 1102, growth of, 1098, ratio to revenue, 1103, national, from 1713 to 1932, 915, public, 914-15 ; depreciation of the currency in, 916 ; distribution of debt between funded and floating as on 31st March 1932, 915 ; distribution of revenue in, 282-84 ; divisions of land in, 405 ; excise in, 665 ; expenditure : and national income, 1083, allowing for prices, 1082, on debt services, 1104 ; extraordinary budget in, 972-74 ; financial policy of, during the War, 918-22 ; fiscal period in, 965-67 ; floating debt in, 923 ; foreign loans in, 922 ; general income tax in, 283, 472-74, 476-77 ; history of public debt in, 913-23 ; history of the pre-War debt in, 916-18 ; indemnity paid by, 836 ; inflation in, 796 ; judicial control in, 1041-42 ; land tax in, 404-6 ; land revenue in percentage of, to total, 713 ; legislative control in, 1044 ; octroi in, 671-72 ; old age pensions in, 124 ; post office, telegraphs, and telephones in, 726, separate budget for, 729 ; refusal to veto budget in, 1014 ; sales tax in, 616-18 ; sources of local revenue in, 283-84 ; State domain, percentage revenue from, 713 ; State monopolies, 283 ; statistics showing national debt and its distribution, 914-15 ; statistics showing ordinary and extraordinary receipts, including internal and external debts, 919 ; statistics showing taxation of local authorities, 753-54 ; succession duty in, 579-80 ; taxation : and national income, 1095, before and after the War, 1090, direct and indirect, 1097, *per capita*, 1091, *per capita*, allowing for prices, 1092 ; tobacco monopoly, 666-67 ; War : finance of, 920, estimate of damage by, 923 ; wealth, 1107
- Francheville, contribution to public finance, 23
- Frank, Tenney, on the infringement of the canon of certainty, 219
- Frederick, subsidies to, 829
- Freycinet, growth of public debt under (France), 918
- Fund, Civil Contingencies. *See* Civil Contingencies Fund Treasury Chest. *See* Treasury Chest Fund
- Funded debt, 1102 ; definition of, 752 ; history of, in Great Britain, 884 ; scope of, 772
- Gallatin, Albert, administration regarding public debt of U.S.A. under, 909 ; fallacy of the old sinking fund, 27
- Galt, Sir A. T., on taxation, 636
- Garfield, President, veto power and, 1013

- Garnier, cited, 20; contribution to public finance, 35; on characteristics of good tax, 213; on progressive taxation, 310
- Gasoline tax, importance of, 261; statistics showing its increasing productiveness, 656
- Gaudin, cited, 917
- Gay, Professor Edwin F., on war loans or subsidies, 829-30
- Geddes Committee on National Expenditure in Great Britain, 5, 1043; criticism by, on the percentage grants, 745-46; examples of retrenchment, 71-72; on extent of beneficial work of the state, 74-75; on reduction of expenditure for defence, 97-98; recommendations relating to statistics and prison labour, 62-63; terms of reference, 59
- General income tax, 282, 472-74, 476-477
- General property tax, main source of revenue for state and local authorities in U.S.A., 280-81; practical working of, 469
- General tariff, 637
- Genovesi, contribution to public finance, 18
- George, Henry, on single tax, 332
- George, Lloyd, cited, 1006; on the debt of belligerent countries, 779
- Georgia, excess profit tax in, 584
- Gerloff, contribution to public finance, 34
- Germany, amusement tax in, 685; area, population, etc., 1071; audit in, 1022; betting and lottery taxation in, 684; budget: legalisation of, 998, military, 1004, preparation of, 954-55, publications connected with, 976; capital levy in, 870; central bank in, restriction in regard to advance to state, 1055; contribution to financial literature, 31; conversion in, 924-25; corporation tax in, 594; cost of War, 1106; debt: analysis of, 1102, growth of, 1098, ratio to revenue, 1103; distribution of revenue in, 275-79; excess profit tax in, 599; excise in, 668; expenditure: allowing for prices, 1082, and national income, 1083, on debt services, 1104; formula in the distribution of revenue in 1936 in, 277; history of income tax in, 475; history of reparations in, 835; indemnities and its effects on, 836-37; inflation in, 795-96; land tax in, 750; local taxation in, 751; main sources of revenue for the Reich, 275-76; poor relief in, 122; public debt, history of, 923-25 (table, 924); sales tax in, 616; shares of local authorities in revenue in, 278-79; statistics showing the distribution of local taxation in, 752; succession duty in, 580; taxation: and national income, 1095, before and after the War, 1090, *per capita*, 1091, *per capita*, allowing for prices, 1092
- Gesamtplan (Germany), 954
- Gibbins, effect of the industrial revolution on labourers, 379
- Giffen, Sir Robert, estimate of Great Britain's wealth by, 818; estimate of India's wealth by, 807 note; on incidence of tax on property and profits, 335; on taking of statistics, 250
- Gifts, as source of public revenue, 204; exemption of, under certain conditions from taxation under death duties of Great Britain, 560
- Gilbert, Sir Jeffery, contribution to public finance, 23
- Ginwala, Sir Padamji, criticism of Budget with reference to India, 6
- Gladstone, cited, 64, 74, 117, 160, 170, 171, 215, 223, 443, 632, 995, 1021; conversion by, 897; "good finance consisting more in the spending than in the collecting of revenues", 63; on death duties, 526; on direct and indirect tax, 297-98, 334; on evasions of income tax, 505-6; on excise, 659; on financial confusion resulting from a disregard of balance between income and expenditure, 83; on graduation, 484; on income tax, 198, 437; extension of, to Ireland, 443; on meeting war expenditure by loans, 160; on penny duty, 675; on supplementary estimates, 189, 970-71; tariff reform by, 627, 632, 633

Goethe, on Napoleon, 917
 Goschen, Lord, conversion of debt by, 898
 Goulburn, conversion by, 897; on sinking fund, 889-90
 Government, classification of functions of, 86-90; corporations and, 938-939; initiation of money bills by, 979, 1001
 Government, business undertakings of, 168; control of foreign trade by, 621
 Government undertakings, expenditure on, in India, 1076-77; revenue from, in India, 1086-87
 Governor of the Bank of England on State's interference, 1057
 Governor, Deputy, of the Bank of England on the closeness and cordiality between a central bank and government, 1054-55
 Governor and Deputy-Governor of the Bank of England are *ex-officio* members, 1052
 Governor of a central bank, appointment of, 1057 note
 Graduated taxation, definition of, 294
 Graduation, according to time, 545; and Rignano's plan, 545
 Graduation of estate duty, 525
 Grants to local authorities, 288-90 note, 292, 738, 745-49, 762
 Gratuitous revenue, 206
 Graziani, cited, 302; contribution to public finance, 36, 37
 Great Britain, absence of complete national account in, 940; accounts in, 1036, making entries in, 1032; administrative control in, 1038-1041; amusement tax in, 686-87; area, population, etc., 1071; audit in, 1045; betting tax in, 683; budget in: annual voting of the whole, 1005, legalisation of, 977, powers of two chambers, 1007-9, publications connected with, 975, preparation of, 951-52, unnecessary procedure regarding, 987-88; capital levy in, 872; central bank in, 1051-52; collection of revenue in, 1023-28; consumption taxes in, 588; conversions in, 861, 895-1000; corporation tax in, 596; cost of War, 1106; custody of public money in, 1024-25; customs:

early history of, 631, as existing at present, 634-36, statistics showing the growth of, 634; death duties in: 556-57, estate duty, 557, legacy and succession duties, 562-63; debt in: analysis of, 1102, and national income, 872, growth of, 1098, history of, 884, owed by and owed to, 822-823, ratio to revenue, 1103, tables showing the burden of, 817, 883, main features, 883, distribution of public revenue in 263; double taxation, agreement between India and, concerning, 319; treatment of visitors regarding, 319-20; entertainment tax in, 686; excess profit tax in, 600-602; excise in, history of, 657, statistics showing net receipts from, 659; expenditure, allowing for prices, 1082, and national income, 1083, on debt services, 1104, fiscal year in, 965: history of tenths and fifteenths, 439; house duty in, 588; income tax in: abatements and, 442, 444-45, 488-90, allowance and, 444-45, 489-90, changes in, between 1894 and 1930, 444-45, extension of, to Ireland, 443, history of, 438, method of assessment and collection of, 454-57, residence and, 319-20, 330, schedules of, 441-42, assessment as per, 490-91, triple assessment of Pitt, 439, 440, 477, 523, 589; inflation in, Committee on Currency and Foreign Exchange on, 796-98; land tax in: early history of, 397-98, revenue from, 398-99, schedules of A and B of income tax as, 399; legislative control in, 1042-45; local taxation in: history of, 743-45, statistics showing, 749, system of grants to local authorities, 746, formula on which it is based, 748, principles governing, 746; lottery loans in, 885; method of spending in, 1030-35; mining in, 715-16; mineral rights duty in, 399-400; octroi in, 671; parliamentary control in: early history of, 977, Government and private Member, 979, various ways by which, is secured, 977-78 note; payments

- by Post Office in, 721 ; payments due to U.S.A., 1105 ; percentage of non-tax revenue to total, 710 ; percentage distribution of tax and non-tax revenue in, 210 ; percentage revenue, direct taxation, 295-96 ; poll tax in, 584 ; poor law in, 119 ; post, telegraphs, telephones, revenue from, 721 ; railways in, fiscal results of, 723 ; revenue, classification of, 1084 ; royal order in, 1031 ; Sinking Fund in, 855-59, history of, 888-95 ; stamp, first use of, for signature of the King, 1032-1033 ; stampduty in, as at present, 678-79, early history of, 678 ; State domains in, percentage revenue from, 713 : subsidies, history of, 829 ; tariff in : number of articles in, 632, principles of, 633, reforms by Huskisson, 627, 632 ; taxation : and national income, 1094, before and after the War, direct and indirect, 1097, *per capita*, 1091, *per capita*, allowing for prices, 1092 ; unemployment insurance in, 129-130, increase in the number of unemployed in, 177-78 ; wartime finance of, twenty-five votes of credit for, 901 ; wealth, 1107
- Great Seal, 1031 ; use of, 1032
- Greece, area, population, etc., 1071 ; capital levy in, 871 ; central bank in, limitations in regard to advances to State, 1055 ; cost of War, 1106 ; debt in : growth of, 1098, ratio to revenue, 1103
- Grenville, Lord, contribution to public finance, 23 ; on Sinking Fund, 855 ; three leading principles of, regarding Sinking Fund, 889
- Hadley, on certainty as canon of taxation, 219 ; on distinction between direct and indirect tax, 208 ; on railways, 723 ; on rates of railways, 728 ; on single tax, 333 ; on State versus private management of railways, 724-25 ; on taxation of capital, 540
- Haliday, contribution to public finance, 23
- Hamburg, wine cellar and apothecary's shop, as sovereign's source of revenue, 200
- Hamilton, Alexander, cited, 950 ; contribution to public finance, 26 ; on payment of debt, 828 ; on the repayment of public debt in U.S.A., 1007-8
- Hamilton, Robert, fallacy of Pitt's sinking fund, 27 ; his twelve maxims of finance, 892-95 ; on sinking fund, 855, 887, 888 ; proposal of sinking fund of, Dr. Richard Price, 887
- Harcourt, Sir William, on estate duty, 558-60
- Harrison, Benjamin, President, veto power and, 1013
- Harrison, William Henry, President, veto power and, 1013
- Hart, Sir Robert, on the estimate of the yield of land tax in China, 424
- Hartley, contribution to public finance, 24
- Harvey, contribution to public finance, 24
- Hasbach, cited, 379
- Hastings, Warren, cited, 155
- Hayes, President, veto power and, 1013
- Hearth tax, 588
- Helfferich, cited, 700
- Henry IV., on the power of the Commons, 1007
- Hermann, cited, 309
- Hertford, Lord, Adam Smith and, 19
- Hertzog, General, on education in the Union of South Africa, 111
- Hesse, triennial budget in, 965
- Higgs, Henry, on audit, 1050
- High Commissioner of India, budget of, 962
- Hill, Rowland, on Post Office reform, 719
- Hitler, cited, 955, 998
- Hoarding, distinguished from saving, 781 ; special characteristics of India, 782
- Hobhouse, Mr., on differentiation, 486
- Hobson, on Stamp duties, 677-78
- Hock, Von, contribution to public finance, 32
- Hoffmann, contribution to public finance, 32
- Holland. *See under Netherlands*
- Homer, on salt, 663

- Hoover Moratorium, object of, 831-832, 835, 847
 Hopkins, Sir Richard, on capital levy, 873
 Horne, Sir Robert, criticism of Budget by, 689
 House duty, in Great Britain, 1084; yield of, 589; in other countries, 1097
 Housing, 126; legislations for, 126-29
 Huet, on inheritance taxation, 546
 Hume, Adam Smith's friend, 19, 20; cited, 813; on Sinking Fund, 868
 Hume, James Deacon, modifications of the British customs laws by, 633
 Hungary, area, population, etc., 1071; capital levy in, 870-71; cost of War, 1106; debt, growth of, 1098; land tax, 407
 Huskisson, on excise, 659; on tariff reform, 627, 632
 Hut, tax on, 388
 Hutcheson, contribution to public finance, 17; on capital levy, 868
 Huxley, criticism on Parnell, 74
 Hythe conference, cited, 835, 846
- Illinois, executive budget in, 957
 Immovable property, definition of, 560
 Impact, definition of, 336, 338
 Impersonal tax, 327; distinguished from personal, by Seligman, 327
 Import duties, effects on agriculture, 622-23; incidence of, 357-61; popularity of, 623; taxes on home-produced goods and, 624
 Impost, definition of, 281
Impôt unique (of the Physiocrats), 22, 331, 332
 Imprests, auditors of, 1046; abolition of the auditors of, 1047
 Improved value of land, tax on, 391, 394
 Improvements on land, land taxation and, 401, 403-4
 Inchcape Committee, 5; examples of economy, 62-63; on expenditure, 98; terms of reference, 98
 Incidence, definition of, 336; distinguished from shifting, 336-37; general principles of, 348-50; on articles of internal trade, 357-63; on building rents, 367-68; on commodities, 351-54; on death duties, 386-87; on income tax, 383-85; on interest and capital, 372-73; on monopoly, 354-57; on profits, 373-77; on quasi-rent, 377; on rates, 369-71; on rent, 364-67; on stamps, 675; on wages, 377-83; use of statistics in, 350-51; various writers on, 339-46
- Income, as basis of assessment, 480, 497; assessable, defined, 487; capital and, 480, 538; differentiation and the nature of, 486; earned, 487, differentiation and, 485; equal sacrifice theory, and the nature of, 306-7; from property, 487; importance of, 259-260, 285; income tax and, 480; investment, 487; money, 480; national: method of calculating: (1) aggregating income method, 238-40, (2) census of producing method, 240-49; percentage of ordinary expenditure to, 190-3; relation of, to public expenditure, 190; non-agricultural, method of calculating in India, 242-49; progression and the nature of, 311-12; real, 480; unearned, 486
- Income tax, abatements: 488, British income tax and, 442, 444-45, 488-90, graduation by, 483, in India, 465-66, on insurance premiums, 494, principles of, 493; bachelors and, 474; basis of assessment: 480, 497, methods of, 498-501, principles of, 498-99, based on the diminishing utility, 485; British: 1084, 1097, abatements and allowance in, 442, 444-445, 488-90, changes in, between 1894 and 1930, 444-49, differentiation between earned and unearned in, 444, 485-88, elasticity of, 438, extension of, to Ireland, 443, history of, 438-54, investments and, 479, rates of, 443, schedules and their scope, 441-42, 449-54, visitors and, 479-80; capital and, 481, 538; collection of, at the source, 492, advantages and disadvantages of, 495-96, benefit of the principle of, 493, from 1913 in the U.S.A., 494-95, importance of, by the Royal Commission, 495; death duties and, 487, 527, 538; definition of, 435; differ-

entiation in, between earned and unearned, 444, 486-88; effect on capital, 538; evasion and: 501-508, importance of, in recent years, 498-501, Pareto's law and, 508-18; exemption limit in, reasons for, 492; family allowance and, 473, 474, 489-90; Gladstone on, 437; graduation and: based on the principle of diminishing utility, 485, criticism of Gladstone and Mill, 484, meaning of, 294, 444-45, 483, methods of effecting, 484, Rignano's plan and, 545, (in France), 472-74, (in Germany), 475, (in Great Britain) 436-57, 1084, 1097, (in India), 462-67, 1086-87, 1097, (in Italy), 474-75, 1097, (in Japan), 470-71, 1097—in the Dominions (Australia), 459-60, 1097, (Canada), 458, 1097, (New Zealand), 460-61, (Union of South Africa), 461-62, 1097, (in the United States of America), 467-470, 1097; incidence of, 383-85, misunderstanding in the, 383-85; investment income and, 479, 487; land tax, compared with, 399; local, as source of revenue, 758-60; main types of, 476; percentage yield of, in various countries, 436; progressive rates of, 287; residence and non-residence concerning, 477-80; Royal Commission on, terms of reference, 436-37; scope of, 477-80

Inconvertible currency, equivalent to forced loans, effects of, 777

Increments, of value of land, 391; taxation of, ways of, 392-96

Indemnities, five classic instances of, 836; principles in fixing, 845-46

India, accounts, method of classification and compilation, 1037; agricultural income, method of calculating, 242-44, 246; amusement tax in, 685; area, population, etc., 1071; borrowing of loans by Federation and Units in, 930; Budget: Appropriation Act and absence of the same, 963, 992, central and provincial, 962, contents and parts of, 961, 963-64, finance committee and, 994, money bills concerning, 990, Gin-

wala's criticism on, 6, procedure in regard to, 962, difference of opinion concerning, solution for, 991, preparation of, 961-62, re-appropriations in regard to, 1010, rulings of the Presidents concerning, 1003-4, spending concerning, 1035-36, veto power and, 1012, votable and non-votable items connected with, 1005; central and provincial governments, financial relations, 271-74; central and provincial heads of revenue in, 270-71, 466-67; changes in the distribution of revenues in recent years, 269-74; conversions in, 927-28; cost of War, 1106; customs: *ad valorem* duties, successful operation of, 628 note, history of (1) up to the year 1861, 641-42, (2) free trade period (1862-1915), 641-44, (3) War and post-Armistice period, 643, and (4) period beginning with the year 1922, 644-45, tariff, forms of a, 627-30; death duties: absence of, 523, 567-68, possible methods of levying, 569-76, during the Moghuls, 567 note; debt: analysis of, 1102, causes for the increase of deadweight, 927, growth of, 1072-73, 1098, 1100-1101, history of, 927-30, productiveness of, 927, ratio to revenue, 1072-73, 1103, table showing public, and interest bearing obligations, 928-29, unique character of, 927; double taxation, arrangement between Great Britain and, as well as Indian states and, 319; excess profits duty in, 603; excise in, 662-65; expenditure: and national income, 1083, allowing for prices, 1082, classification of, 1076-77, growth of, 1072-74, increase in, 1081, on debt services, 1104; finance members of, 1072-74; forests in, 713; Government of India Act in, 963; hoarding in, 782; income tax: as at present governed by Income tax (Act XI. of 1922) and amended, 1933, 464-465, graduation in, 465-66, history of, 462, introduced by James Wilson in 1860, 462, schedules of,

462 ; irrigation, revenue from, 717 ; land tax in : 407, assessment of, 411, percentage of land tax to total agricultural produce, 408, permanent and temporary settlement, 411-16, under Moghul period, 409 ; national income, calculation of, 247-48 ; non-agricultural income of British, 242-49 ; legislative control in, 1044 ; octroi in North-Western, 671-72 ; *per capita* debt, 1072-74, 1098, 1100-1101 ; *per capita* expenditure, 1072-74 ; *per capita* revenue, 1071, 1072-74 ; percentage distribution of public revenue to total revenue, 709 ; percentage revenue in direct taxation, 295 ; poll tax in, 582 ; postal, telegraph and telephones services, net revenue from, 721, fiscal results in, 722, investment habit in, 928 ; railways, fiscal results of, 722, management of, 725, separate budget for, 730-31, 962 ; reserve bank in, 1054 ; revenue : classification of central and provincial governments, 1086-1087, local bodies, 1088, distribution of central and provincial governments, 1089, taxation : and national income, 1094-95, before and after the War, 1090, 1096, burden of, 1096, 1097, central, provincial and local, 1096, direct and indirect, 1086-87, 1088, *per capita*, 1091, 1096, *per capita* allowing for prices, 1092 ; treasury system for custody of public money in, 1035-36, methods of paying and receiving, 1028-29, 1030 ; wealth, 1107

Indirect tax, Adam Smith on, 297 ; characteristics of, 299-300 ; definition of, 207-9, 295 ; Gladstone on, 805-6 ; ratio between direct and, 296 ; relation between direct and, 296 ; scope of, 673

Indirect taxation, 1097

Inductive method, meaning of, 9

Industrial activities of the State, 715-716 ; advantages of, 717

Industrial classes and protective duties, 357-58

Inelastic demand, burden of taxation and, 349 ; commodity taxes and,

352-53 ; taxation of wages and, 381-83

Inflation, definition of, 794

Inheritance tax, advantages of, 548 ; arguments for and against, 524-525 ; definition of, 522, effects of, 541-45 ; general principles of, 524-26 ; history of, 523-24 ; in federal constitutions, 552-56 ; in France, 579-80 ; in Germany, 580 ; in Great Britain, 556-63 ; in Holland, 581 ; in India, 567-74 ; in Italy, 580 ; in Japan, 581 ; in Spain, 581 ; in the Crown Colonies, 576 ; in the Dominions : Australia, 564-65, Canada, 563-64, New Zealand, 565-66, Union of South Africa, 566-67 ; in the United States of America, 577-579 ; justifications of, 526-27 ; popularity of, in federal constitutions, 521 ; revenue of, in federations, 555 ; Rignano's scheme of, 545-51 ; statistics showing the importance of, in federal countries, 553 ; whether the tax should be levied by the Federal or State government or by both, 552-556

Institute of Government research, 957

Insurance, national, 124, social, 123 ; unemployment, 125

Insurance premiums and death duties, 539 note

Interest, incidence of a tax on, 339, 341 ; receipts (India), 1086-87

Inter-governmental debts, first instance of, 828 ; suspensions of the payment of, 832. *See* War debts

Intermediate tariff, 637

Internal debt, 771 ; for economic development, 811, 1102

Internal taxes on consumption. *See* Excise

International Settlements, Bank of, advantages of, 1067 ; difficulties of, 1066-67 ; functions of, 1066 ; limitations on, 1055, 1067 ; object of the creation of, 1066 ; origin of, 1065

International trade, taxes on, incidence of, 357-63

Investment income, 548 ; British income tax and, 479 ; income tax and, 487

- Ireland, extension of income tax to, 443; sinking fund of, 888
 Irrigation, expenditure on, 1076-77; revenue from, 717-18, 1086-87
 Italy, agricultural profits tax in, 406; amusement tax in, 685; area, population, etc., 1071; capital levy in, 870; contribution to the science of public finance, 36-38; cost of War, 1106; debt: analysis of, 1102, growth of, 1098, ratio to revenue, 1103; excise duty in, 667-68; expenditure: allowing for prices, 1082, and national income, 1063; income tax in, 474-75; land tax in, 406; octroi in, 672; publications connected with budget in, 976; State domain, percentage revenue from, 713; succession duty in, 580-81; state monopoly in, 667; taxation: and national income, 1094-95, before and after the War, 1090, direct and indirect, 1097, *per capita*, 1091, *per capita*, allowing for prices, 1092, wealth, 1107
- Jack, estimate of cost of consumption in Bengal, 254
 Jackson, President, veto power and, 1013
 Jaeger, contribution to public finance, 40
 Jamaica, succession duty in, 577
 Jamieson, Sir G., on China, 423-24
 Japan, area, population, etc., 1071; borrowing by, 925; cost of War, 1106; central bank in, 1063; customs tariff in, 648-49; debt: analysis of, 1102, growth of, 1098, history of, 925-27, ratio to revenue, 1103; excise in, 668-70, revenue from, 668; expenditure: allowing for prices, 1082, and national income, 1083, on debt services, 1104; extraordinary budget in, 972; floating debt, increase in, 927; income tax in, 470-71; indemnities received by, 837; inheritance tax in, 581; internal loans and their effects, 926; land tax in, 425; local taxation, statistics, 754-55; percentage revenue of direct taxation in, 295; railways, fiscal result of, 723; separate budget for, 729-30; table showing budget deficits and public debt, 926; taxation: and national income, 1094-95, before and after the War, 1090, direct and indirect, 1097, *per capita*, 1091, *per capita*, allowing for prices, 1092
- Jefferson, cited, 908; on repayment of debt, 828; veto power and, 1013
 Jefferson, Thomas, cited, 715
 Jevons, contribution to public finance, 37
 Jèze, contribution to public finance, 35; on classification of debts, 757-58; on French budget, 953
 Joanna, daughter of Richard le Tailleur, 946
 John, the mason, 945
 Johnson, President, veto power and, 1013
 Johnson, Dr., on excise, 659
 Joint-stock banks, 1053
 Jones, Richard, on Ricardian theory, 344
 Judicial control, 1016; in France, 1041-42
 Justi, Von, contribution to public finance, 18; on expenditure, 96; on the percentage relation of public expenditure and national income, 190
- Kameralwissenschaft, 18
 Kautilya, 3, 13
 Kemmerer, on the advantage of the federal reserve system in the United States of America, 1053
 Keynes, on capacity to pay, 846
 King, arriving at national income by, 700
 Kitchener, Lord, cited, 1049
 Knowledge, tax on, 659
 Kulisher, contribution to public finance, 40
 Labour party on capital levy, 863
 Land custom duties, earlier in origin, 620
 Land revenue, whether rent or land, 407; in India, 1086-87
 Land tax, basis of, 390, 432-34; characteristics of, 388; compared with income tax, 399; in China, 422-25, defects of, 424-25; in France, 404-6; in Great Britain, 397-400, 1084, 1097, schedules A and B of income tax as, 399; in

- India, during Moghul period, 409; future of settlement regarding, 420-21; Joint Parliamentary Committee and, 420; *per capita* land revenue, 418; percentage to total agricultural produce, 408; rates of assessment, 411, 415-16; reforms and, 420-21; table showing rates of assessment per acre and with regard to temporary and permanent settlement in various provinces, 417; temporary settlement of, 411-13; in Italy, 406; in Japan, 425-27; in other countries, 407, 1097; in Rome, 384-85; in the Dominions: Australia, 400-402; Canada, 403; New Zealand, 402-3; mortgages of, 402; Union of South Africa, 403-4; in the United States of America, 427-32; local taxation and, 758-759; main lessons of, in Great Britain and the Dominions, 404; method of levying the tax, 389; on unimproved value of, 401, 403
- Land values, taxation of, 390; reasons for the increase in, 391
- Land value duties, 1084
- Latvia, area, population, etc., 1071; debt, 1098; State-owned central bank in, 1056
- Lausanne agreement, 832, 835, 842
- Law, Sir Edward F. G., on customs, 643
- Law and justice, expenditure on, in India, 1076-77
- Law and order, as primary function of State, 99-100; expenditure on, in India, 1076-77
- Layout, Sir W. T., on data regarding distribution of national debt, 104, 816; on national income, 238
- League of Nations, classification of revenue by, 207; control of, in regard to inter-State borrowing, 824; question of double taxation and, 324-26
- Leake, P. D., cited, 333 note
- Least aggregate sacrifice, as theory in the distribution of the burden of taxation, 307-9; factors underlying, 308; incomes and, 308
- Legacy duty, 525; as one of the main sources of death duties in Great Britain, 556; exemptions of, 563; ratio, 562
- Legislative Assembly, 991-95; refusal to veto budget in, 1014
- Legislative budget, 956
- Legislative control, 939, 1042-45
- Legislative council, 992-95, refusal to veto budget, 1014; rulings on non-votable items by, 1004-5
- Legislatures, control by, 1042-45, powers of, in U.S.A., 998-1000
- Leroy-Beaulieu, arbitrariness of progressive taxation, 314 note; attempt of, to lay down a percentage figure for the service of debt, 105; intention of legislation at the basis of distinction of direct and indirect tax, 209; on commercial and industrial activities of State, 715; on management of local finance, 292; on progressive taxation, 310; on property tax, 742
- Leslie, Cliffe, cited, 344
- Levy, Capital. *See* Capital levy
- Lincoln, President, veto power and, 1013
- Lindahl, contribution to public finance, 40
- List, Friedrich, cited, 58; on protective duties, 624
- Loan, treatment of, as revenue, 201, 204
- Loan Council, operation of, in Australia, 153, 267, 293, 931, 932
- Loans, camouflaged, 913
- Loans, capital and, 785-86, 792, 794; capital accumulation and, 791; cases where necessary, 166-67; chance, 779; effects of, on rich and poor, 792; effects of large amount of, 792; forced, 777, 788, 802-3; foreign, 771, 811; justifications of, 792; lottery, 778-79, 800-801, 885; methods of, and principles of floating, 798-803; political and psychological nature of, 792-93; repayment of, 794; shifting of the burden of, 793; versus taxation, 789
- Local authorities, expenditure of, 732, 1078-79; general principles in regard to the permission to borrow by, 173-77; growth of expenditure on public works by, 172; limits to, regarding debt, 879; property tax as source of revenue to, 736-38; services ad-

- ministered by, 734, 735, 736; similarity of sources of revenue to, in various countries, 736; subventions or grants to, 734-35; supplements to taxes for, as a great source of revenue in various countries, 736; various sources of receipts to, 738-63, in India, 1088
- Local debt, increase of, due to extensive administrative functions, 780, 878; limitations to, 879, methods of raising, 878
- Local finance, control over, 764-65; executive in, 763-64, necessity of, 765-66; jurisdictions in, 766
- Local loans, methods of raising, 878; methods of repayment, 879
- Local rates, statistics showing, 749
- Local taxation, 1096; differences in, in various countries, 758; growth of, 262, 732; in France, 753-54; in Germany, 750-52; in Great Britain, 745-50; in Japan, 754-755; statistics showing, 749, 752, 753-55; statistics showing the importance of, 733; variations of, from locality to locality, 660-61
- London money market, compared with New York money market, 1053-54
- Lotteries, monopoly of, 667; taxation, 681
- Lottery loans, 778-79, 800-801; history of, 885
- Lotz, contribution to public finance, 34
- Lutz, contribution to public finance, 30
- Luxury taxes, 614-15; demand and, 615
- Lyndraper, Greyn le, cited, 945
- McCulloch, J. R., cited, 309; contribution to public finance, 29-30; estimate of public debt in 1847 (Great Britain), 800; justifications of loan for national security, 165; on capital levy, 868; on principle of proportionate sacrifice, 217; on incidence of customs duties, 359; on sinking fund, 855, 876; on taxation of rent, 366; on taxation of wages, 341
- MacDonald, Dr. A. F., on federal subsidies for education, 112
- MacDonald, Mr. Ramsay, on capital levy, 873-74
- McKenna, Mr., on the scope of budget, 188; on the taxable capacity of Great Britain, 251
- McKenna duties, abolition of, 632
- McKinley, President, veto power and, 1013
- McKinley tariff in U.S.A., 646
- Madison, President, cited, 908; veto power and, 1013
- Madox, contribution to public finance, 23
- Madras, tax on toddy in, 663; thirty years term of land revenue settlement in, 413
- Madura, hoards in, 783
- Maecenas, cited, 784
- Magna Charta, ancient and equitable duties and the old customs, 397, 621; restrictions on land tax, 397; taxation and, 977
- Mallet, Sir Bernard, enquiry by, 692
- Malthus, cited, 344
- Mansfield, Lord, diffusion theory of taxation, 336, 345
- Marginal tenth, 218
- Marin, Mareel, contribution to public finance, 916
- Marin, M. Louis, on repayment of debt, 825
- Marshall, estimate of economic wealth of a nation from the aggregate national income multiplied by the average income, 249; on equitable taxation, 303; on graduated sharing of the burden, 218; on incidence of a tax on international trade, 360; on inheritance tax, objections to, 536; on Ricardo's reasonings on profits, 343; on taxation of rent, 367; on the function of analysis and deductions in economics, 9-10
- Martin, Mr., a subscriber to a tontine, 775
- Maryland, budgetary procedure in, 956
- Marx, cited, 332
- Mase-Dari, cited, 302
- Massachusetts, budgetary procedure in, 956
- Massie, contribution to public finance, 23
- May, on supplementary estimates, 970
- May Committee (Great Britain), 1043; on expenditure chargeable to

- capital, 178 ; terms of reference, 59
- May, Sir Erskine, on land revenue of Great Britain at the end of William's reign, 713 ; on veto, 1014
- Mazarin, Cardinal, on octroi, 671
- Mazzola, cited, 302 ; contribution to public finance, 36
- Meat, tax on, source of local taxation, 763
- Medical and sanitation, expenditure on, in India, 1076-77
- Meisel, contribution to public finance, 34
- Mellon, on debt, 778 ; on internal borrowing, 813 ; on sound tax policy, 222-23
- Member banks, central banks and, 1060
- Menger, contribution to public finance, 37
- Meston, Lord, on the revision of land revenue settlement in India, 421
- Mexico, national railways in, 724, 726-727
- Micum, 838
- Middle classes and bank credits, 786
- Military budget in Germany, 1004
- Military expenditure (defence, India), 1076-77 ; receipts from, 1086-87
- Military war tax, 918
- Mill, essay on Coleridge, 10 ; contribution to public finance, 27
- Mill, John Stuart, on abatements, 488 ; on benefit of state expenditure, 57 ; on capital levy, 868 ; on classification of public expenditure as necessary and optional, 88 ; on customs duties, 624 ; on death duties, 386 ; on direct and indirect tax, 208 ; on equal sacrifice theory, 306 ; on graduation, 484 ; on methods of taxation, 217 ; on principles underlying State expenditure, 156 ; on progressive taxation, 310 ; on public value of land, 392 ; on rent and wages, 344-45 ; on stamp duty, 676 ; on taxation of : future unearned increment, 332, of international trade, 359-60, of surplus, 591, of wages, 380-81
- Mineral rights, duty on, 399-400
- Mines, public property, 715-16
- Minimum consumption, definition of, 229
- Minimum sacrifice, as a doctrine of taxation, 307-9
- Minimum standard, definition of, 292
- Minimum subsistence, meaning of, 229
- Minister of Finance, his part in the preparation of budget, 949-55
- Mint, expenditure on, 1076-77 ; revenue from, 1086-87
- Mirabeau, the elder, contribution to public finance, 22, 23 ; on land tax, 331 ; on voting, 1004
- Miscellaneous, expenditure in India, 1076-77
- Mississippi, repudiation in, 788, 862 note
- Mobility of capital and labour, as a condition in the shifting of a tax on commodities, 351
- Moll, contribution to public finance, 34
- Mollien, cited, 917
- Mollien, le bon, appreciation of *Wealth of Nations*, 25
- Money bills, definition and scope of, 991 ; initiation of, 990, 1101-4 ; provincial governments of India and, 992-93
- Money income, as basis of assessment, 481
- Money market, London and New York, compared, 1053-54
- Monopolies, incidence of a tax on, 354-357, revenue from, 1097
- Monopolists, distinguished from producer, 354 ; kinds of, 355 ; manipulate the output so as to yield the highest revenue, 354
- Monopoly gains, tax on, 312 ; incidence of taxes on, 354-57
- Monopoly State, 667, 717
- Monroe, President, veto power and, 1013
- Montchrétien, on capital levy, 873
- Montesquieu, contribution to public finance, 15, 20 ; cost of defence, 96 ; on progressive taxation, 310 ; on progressive taxation in ancient Athens, 217
- Montgomery, on income tax procedure, 496
- Moratorium, Hoover, object of, 831-832, 835, 847

- Moreau de Beaumont, Adam Smith's indebtedness to, 214
 Morellet, contribution to public finance, 23
 Morrill tariff of 1861 in U.S.A., 646
 Mortgages, land tax and, in New Zealand, 402
 Motor vehicles, taxation of, 588, 1084; as source of local revenue, 738
 Mucklebackit, Maggie, cited, 230
 Munitions levy, 600-602
 Munro, Sir Thomas, cited, 411
- Napoleon, Bank of France and, 1029, 1041, 1042; on indemnities, 836, 995, public debt of France under, 917
 Napoleon III, public debt of France under, 917
 Natal, succession duty in, 566
 National Bank. *See* Central bank
 National debt, compared with individual's debt, 787. *See under* Public Debt
 National debt and taxation, committee on. *See under* Committee on National debt and taxation
 National guard, 281
 National income, and government expenditure, 1083; and taxation, 1094-95; percentage of ordinary expenditure in different countries to, 190-93; relation of, to public expenditure, 190
 National Tax Association, 431, 548, 595, 598
 Nationalisation of banks, dangers in, 1057 note
 Natural liberty, function of the sovereign according to the system of, 54
 Navy bills, 884
 Nebenius, contribution to public finance, 32
 Nebraska, executive budget in, 957
 Necessities, avoidance of tax on, 310; incidence of tax on, 353
 Necker, contribution to public finance, 23, 916
 Negative abatements, 488
 Netherlands (Holland), 824; abolition of local income tax in, 262; area, population, etc., 1071; debt: analysis of, 1102, growth of, 1098, ratio to revenue, 1103; expendi-
- ture on debt services, 1104; inheritance taxation in, 523, 581; octroi in, 671-72; sovereign's fund in, 200
 Neumann, contribution to public finance, 34
 Nevada, absence of inheritance tax in, 522
 New Mexico, executive budget in, 957
 New South Wales, betting tax in, 682; death duty in, 564
 New York, money market, compared with London money market, 1053-54
 New Zealand: central bank in, 1051; charitable relief in, 124; cost of War, 1106; death duties in, 565-66; debt: analysis of, 1102, growth of, 1098, ratio to revenue, 1103, public history of, 930-33; excess profits tax in, 602; excise duty in, 660; expenditure on debt services, 1104; income tax in, 460-61; land tax in, general features of, 401; mortgage and, 401; railways in, fiscal results of, 723; tariff system in, 639-40
 Nicholson, contribution to public finance, 30, on classification of public expenditure, 86-87; on common benefit and some special benefit in all kinds of public expenditure, 86; on ideal of public expenditure, 78
 Nitti, contribution to public finance, 36
 Non-agricultural income: method of calculating, 242, 246; Mr. Dadabhooy Naoroji's estimate of, in British India, 243; criticism, 244; scope of, 245; tables showing, 243-44
 Non-residents, taxation of income and, 477-80
 Non-tax revenue, as one of the main heads in classification, 211; revenue from, in various countries, 709-10, 1084, 1086-87; scope of, 708; statistics showing the percentage of, to total, 709
 Norman standard, definition of, 292
 Norman, Mr., on difficulties of International Bank of Settlements, 1066-67; on State interference with central banks, 1056

- North, stamp duty upon any receipt for any legacy or share or residence of the personal property of a deceased person, 523
- North, Lord, Adam Smith and, 535
- Northcote, Sir Stafford, formation of his new sinking fund in 1875, 890
- Norway, area, population, etc., 1071 ; debt : analysis of, 1102, growth of, 1098, ratio to revenue, 1103 ; expenditure on debt services, 1104 ; succession duty in, 522
- Note issue authority of a central bank, 1059-60 ; reason why Government is not entrusted with, 1060
- Occasional profits, taxation of, 481, 536
- Occasional property, taxation of, 542
- Occupier, incidence of building rent on, 367-69
- Octroi, as a source of local taxation, 756-58 ; definition of, 670-71 ; disadvantages of, 671 ; early history of, 671 ; system of excise, 670 ; unpopularity of, 672
- Ogilvie, on land values, 332
- Ohio, real and personal taxation in, 740
- Old age pensions, 123, in various countries, 124 ; qualifying age for, 132 ; rates of, in Great Britain, 132-33, in the U.S.A., 134 ; whether it should be contributory or non-contributory, 131
- Onerous rates, 734
- Open market transactions of a central bank, 1059
- Opium, duty on, 662 ; revenue from, 1086-87
- Ordinary and extraordinary expenditure, 93-94 ; classification of public revenue into, 206 ; definition of, 187 ; scope of, in various countries, 188
- Orissa, Bihar and, thirty years term of land revenue settlement in, 412, 414, 419
- Paine, on the absorption of rent by taxation, 332
- Palgrave, on criminal proceeding in early times, 945
- Pantaleoni, contribution to public finance, 36, 37
- Paper currency reserve, 1030
- Par exercice*, account, its closing in France, 966-67
- Par gestion*, account, its closing in France, 966-67
- Pareto, contribution to public finance, 37-38 ; Law of, as test of accuracy of income tax returns, 508 ; objects of, 509 ; should no longer be used for tax evasion, 516-18 ; statistics according to, 511-15
- Parieu, De, contribution to public finance, 35
- Parliament, financial powers of, 950, 977-78, 1007 ; ruling on voting of expenditure, 1006
- Parliamentary control, meaning of, 942
- Parnell, Sir Henry, on methods of public expenditure, 1019 note ; on overgrowth of expenditure, 28 ; on scope of expenditure of government, 73-74
- Parsimony, contrast to economy, 61
- Partial repudiation. *See under Repudiation*
- Paul, Herbert, on civil service, 101
- Paymaster-General, 945 ; duties of, 1034-35 ; his accounts, 1033-34 ; his office, 1033 ; paying agent of government, 1033
- Payments due to U.S.A., 1105
- Payne tariff in U.S.A., 647, 648
- Peddling, tax on, 737, 756
- Peel, Sir Robert, abolition of customs duties by, 299, 627, 633 ; income tax and, 435, 439, 442-43, 444
- Pelham, conversion of debt by, 896
- Pennsylvania, budgetary procedure in, 956 ; inheritance tax in, as early as 1826, 523
- Pensions, old age, in various countries, 123-24 ; qualifying age for, 132 ; rates of, in Great Britain, 132-33, in U.S.A., 134 ; whether it should be contributory or non-contributory, 131
- Pepys, Samuel, on poll tax, 584 ; on Sir Stephen Fox, 1019
- Per capita*, debt, 1071, 1072-73, 1098, 1100-1101 ; expenditure, 1071, 1072-74 ; allowing for prices, 1082 ; national income, 1071 ; revenue, 1071, 1072-74 ; taxa-

- tion : allowing for prices, 1092, before and after the War, 1091
- Permanent Settlement, of land revenue, 411-13; future solution of the problem of, by the introduction of income tax similar to that of Great Britain, 420-21
- Perpetual rentes, borrowing in, 849
- Pershing, General, cited, 829
- Personal tax, distinguished from Impersonal, 326, 327
- Petition of Rights, 977
- Petrol tax, statistics showing revenue from, in U.S.A., 656
- Petty, Lord Henry, a scheme of Sinking Fund, 888
- Petty, Sir William, contribution to public finance, 8, 15, on the estimate of national income, 238
- Physiocrats, doctrine of taxation, 21; *impôt unique*, 21, 331, 332; on the incidence of a tax, 329; *produit net*, 21, 215, 331, 339
- Pierce, President, veto power and, 1013
- Pierson, cited, 302; contribution to public finance, 38
- Pigou, A. C., classification of expenditure into transfer and non-transfer expenditure by, 89-90; on capital levy, 865; on double taxation, 318; on equal sacrifice, 218; on taxation of surplus, 591; on windfall taxation, 605
- Pitt, assessed taxes, 439; income tax, 435, objections to differentiation in, 486; increase of stamp duty by, 523; land tax of, 398; on customs duties, 632; on direct consumption taxes, 588; on evasions of income tax, 505; sinking fund of, 888, 895; struggle with Fox, 1014; subsidies by, 829; triple assessment of, 439-440, 477, graduation in, 484
- Plato, cited, 255; on education, 113; on salt, 663
- Plehn, classification of public expenditure by, 85; contribution to public finance, 30
- Poland, area, population, etc., 1071; capital levy in, 869; debt in, 1098; health insurance in, 124
- Police, expenditure on, in India, 1076-1077
- Polish levy, result of, 869
- Political debt, expenditure on, in India, 1076-77
- Political loans, for financial reconstruction, 823; dangers of, 824
- Polk, President, veto power and, 1013
- Poll taxes, believed to be earlier in origin, 388, 582; early history of, 583-84; in Assam (India), 587; in Burma (India), 581; in the United States of America, 585; in the Union of South Africa, 585-86
- Poor rate, 149, 151
- Poor relief, in England, 119; in France, 122; in Germany, 122; in India, no system, 123, provision against famine relief, 123; in Japan, 123; in New Zealand, 123; in Scotland, 120-21; in the United States of America, 122
- Population, increase of, as one of the causes for the growth of public expenditure, 48-49; of various countries, 1071
- Ports and pilotage, expenditure on, in India, 1076-77; revenue from, in India, 1086-87
- Portugal, cost of war, 1106; debt, growth of, 1098, ratio to revenue, 1103; octroi in, 671-72
- Postlethwaite, James, contribution to public finance, 23
- Postlethwayt, Malachy, contribution to public finance, 24
- Post Office, collection of revenue by, 947; early history of, 718; estimates of, 952; functions of, and principles of charging revenue, 719-20; payments by, in Great Britain, 721; statistics showing net revenue from, in various countries, 721; whether, should produce a considerable revenue to State or should simply pay its way, 720
- Post, and telegraphs, expenditure on, in India, 1076-77; revenue from, in Great Britain, 1084, in India, 1086-87
- Preferential tariff, 637
- Premium loans, 779
- Premiums, Insurance, income tax and, 491-92; death duties and, 425 note
- President and the budget in U.S.A., 957
- Presidents and veto power in U.S.A., 1012-13

- Presumptive income tax, one of the types of income tax, 477
- Price, compared with tax and fees, 202; definition of, 202
- Price, Sir Richard, contribution to public finance, 23; his scheme of sinking fund in his treatise, 855, 856, 888; on repayment of debts, 895
- Price-level, capital levy and, 864, 868; finance by bank credits and, 794-798; increment duties on land and, 391, 393-94
- Prices, index numbers of, 804, 1090
- Prideaux, Edmund, postmaster, 718
- Primary expenditure in India, 1076-77
- Principles, a conflict of, 224-25
- Privy Seal, 1031; use of, 1032
- Producer, distinguished from monopolist, 354
- Productive and unproductive expenditure distinguished, 189-90
- Productive debt, burden of, 811-12
- Product net*, 21, 215, 331, 339
- Professional earnings, taxation of, 443
- Profits, elements of, 365, 373; incidence of a tax on, 373-77, by various writers, 339-44; agricultural: taxation of, in Italy, 406; excess: taxation of, 598-605; occasional or non-recurring, tax on, 481
- Progressive taxation, definition of, 299; future of, 313; increasing popularity of, 310, 314; objections to, by classical economists, 310; relation to nature of income, 311; relation to proportional sacrifice theory, 309-10; supporters among the precursors of Adam Smith, 310
- Property, movable and immovable, 560; administration of a tax on, 723; fixing of rates, 741; rates: in England, Wales, and Scotland, 560; in Germany, 750; taxation of, in U.S.A., 739-40; history of, 739-40
- Proportional taxation, characteristics of, 309; definition of, 294-95; relation to equal sacrifice and classical economists, 309
- Protective duties, contrasted with revenue duties, 623; demand and, 623-24; general economic considerations concerning, 623-25; home industries and, 624; prices and, 624-25; rising and infant industries and, 624-25
- Provincial rates, revenue from, in India, 1086-87
- Prussia, disappearance of export duties in, 621; fiscal year in, 965; indemnity paid by, 836; local taxation in, 750; principles of "K.A.G." in, 752-53; property tax and rates, 750; railways in, 726; separate budget for railways in, 729; refusal to vote budget, 1014; seven years' budget in, 965
- Public Accounts, absence of complete, in Great Britain from 1714 to 1822, 940-42
- Public Accounts, Commissioners of, recommendation for one fund, 941
- Public Accounts Committee, 1021; legislative control by, 1042
- Public Authorities, definition of, 3
- Public credit, a product of modern times, 781-84; advantages and disadvantages of, 785-87; capital and, 785-86; finance of, by recourse to banks, 794, causes for the recourse, 795, effects of creating, 787, 795, 798, general conclusions, 795, inferiority of, to taxation, 795, poorer classes and, 795; individual's expenditure and, 795; permanent nature of, 787; private and, compared, 787-88; state hoarding replaced by, 784
- Public debts: analysis of, of some countries, 1102; burden of: comparison of the actual or market value of debts as an index of the, 810; direct and indirect, 811-18; factors to be considered in the estimate of the, 804; factors to be considered in comparing the, of various countries, 807; methods of estimating the (1) percentage of public debt to national wealth (table), 806, (2) percentage of debt charges to national income (table), 806, (3) *per capita* (table), 807, (4) proportion of expenditure for the debt services in relation to the annual budget, 808-9, (table) 810; in Great Britain, 817; of various countries, 804; charac-

- teristics of, 776-77 ; classification of, 771, 775 ; definition of, 771 ; growth of, 779, in various countries, 1098, in India, 1072-73, 1098, 1100-1101 ; history of : in Australia, 930-33, in France, 913-923, in Germany, 923-25, in Great Britain, 882-906, in India, 927-30, in Japan, 925-27, in New Zealand, 930-33, in the United States of America, 907-13 , internal, for economic development, 811 ; national wealth and, 818-20 ; of India, 1072-73, 1100-1101 ; of twenty-seven countries, 779 ; of various countries, 808, 1071 ; *per capita*, of India, 1071, 1072-73, 1098, 1100-1101, of various countries, 1071, 1098 ; principles of floating, 799-803 ; productiveness and unproductiveness of, 811-12 ; ratio to revenue, 780, 1103 ; repayment of : absence of any formula in, 853, advantages and effects of, 851-54, early history of, in various countries, 849-51, methods of : (1) sinking fund, 854-59, (2) conversion, 859-62, (3) repudiation, 852, 862-64, 788, (4) capital levy, 864-78—other methods of, 852, taxation and, 853, usual method of, 852 ; scope of, 881-82 ; services on, in terms of ordinary expenditure, 1104 ; table showing the percentage yield of bonds in various countries, 809 ; table showing the total of, of the United Kingdom in 1914-1920, and other years, in actual figures and reduced to the pre-War price-level, 805
- Public domain, basis of public revenue in early times, 712 ; gradual diminution of, 713 ; revenue from, 710, 713-14
- Public enterprises, commercial and industrial, 715 ; canals, 721-22 ; irrigation, 717-18 ; manufactures, 716-17 ; mines, 715-16 ; monopolies, 717 ; posts and telegraphs, 718-21 ; railways, 721-31 ; tramways, 722
- Public expenditure, canons of, 77-83 ; capital, chargeable to, 159-86 ; classification of, 84, 88-93 ; distribution of, 1078-80, percentage, in various countries, 94 ; economic development, 143 ; economy and, 79-80 ; growth of, 93 ; ideal of, 75 ; national income and, 190 ; normal, of a country determined by historical conditions or previous legislation, 63 ; of different countries, 93-94 ; private expenditure and, compared, 70-72 ; scope of, from individualistic standpoint, 72-74, from socio-political standpoint, 74-76
- Public health, expenditure on, in India, 1076-77
- Public money, custody of, 1028 ; in France, 1029 ; in Great Britain, 1029 ; in India, 1028 ; in U.S.A., 1029 ; payment of, and receipt of, 1030
- Public revenue. *See under Revenue*
- Public value of land, taxation of, 390, methods of, 392-96 ; effect on prices, 391
- Public works, expenditure on, in India, 1076-77 ; revenue from, in India, 1086-87
- Pudlicote, Richard de, cited, 945, 946
- Punjab, twenty years term of land revenue settlement in, 413
- Pupin, divisions of, national income by, 700
- Purchasing power, 4, 46 ; effect of credit creation and, 787, 795
- Pym, introduction of direct taxation into England by, 657
- Pyx Chamber and chest, 946
- Quasi-personal taxes, 476
- Quasi-rent, definition of, 377 note ; incidence of tax on, 377
- Queen Victoria, on death duty in Great Britain, 558-59
- Queensland, death duty in, 564-65 ; tax on unimproved land values in, 401
- Quesnay, contribution to public finance, 22 ; on incidence of tax on land, 339 ; on single tax, 331
- Railways, Aeworth Committee's arguments for and against, in regard to State management, 725-26 ; capital on, 723 ; expenditure on, in India, 1076-77 ; financial results of, in different countries,

- 723 : fixing of rates, 727-28 ; in Prussia, 726 ; in various countries, 726-27 ; Inter-State Commerce Commission on, 728-29 ; proportion of world's mileage of, in different countries, 722-23 ; revenue from, in India, 1086-87 ; separate budget for, 141, 729-31
- Raja Todar Mal, cited, 411
- Ralph Allen of Bath, cited, 719
- Rates, definition of, 369 ; incidence of, in regard to taxation of site value, 370-71 ; on property as a source of local revenue, 734, 738-742 ; table showing local, 749
- Rau, contribution to public finance, 32, 205 ; on fees, 203
- Real income, as basis of income tax, 480
- Real property, estate duty and, 560
- Reappropriations, 809
- Reciprocal tariff, 637
- Reed, David, Senator, on sales tax, 610
- Refunds, drawbacks of, 1076-77
- Registration duties, 673, 675-76 ; revenue from, in India, 1086-87, in other countries, 1097
- Regressive tax, definition of, 294, 313
- Reichsbank, 955 ; German Government and, during the War, 795
- Reichsrat, part played by, in the legalisation of the budget, 996-97, in the preparation of the budget, 954-55
- Reichsschuldenverwaltung, administration of national debt by, 955
- Reichstag, part played by, in the legalisation of the budget, 997, in the preparation of the budget, 955
- Relative taxable capacity, British Treasury's Memorandum on, 231 ; definition of, 231 ; examples of, 228 ; factors to be taken in constructing an index of, 255-56 ; method followed in Australia, 257 ; result in India, 257 ; use of income tax alone for, is not satisfactory, 255 ; various tests of, in Great Britain, 231-32
- Religion, expenditure on, in Great Britain, 118 ; in France churches separated from State in 1905, 118 ; Welsh Church Acts, 1914 and 1919, 118
- Rent, incidence of a tax on, 365-67 ; not a factor affecting price, 364 ; tax on : Adam Smith's theory of, 340-41, Mill's theory of, 345, Physiocrats' theory of, 339, Ricardo's theory of, 342
- Rents, building, incidence of tax on, 367-69
- Rents, true, tax on, 365-66
- Reparations, Agent-General for, 840 ; burden of, 844-45 ; close connection of, with War debts, 835 ; definition of, 834 ; four points in the history of, 844 ; future of the transfer problem of, 847-48 ; history of, 835-44 ; relationship between paying and receiving countries, 835, transfer and, 846-847 ; war indemnities and, 833
- Repudiation of debt, definition of, 844 ; distinguished from default, 863 ; effects of, 863-64 ; method of repaying debt, 852 ; partial, 862-863 ; usual forms of, 863
- Reserve Bank of India, 1054
- Reserve Bank of South Africa, 1051
- Reserve Banks, Federal, in U.S.A., 1052
- Reserve funds, 1010
- Residence, British, in relation to income tax, 320-21, 330 ; definition of, for purposes of taxation, 328
- Responsibility of central authorities in giving grants to Units, 290
- Revenue, public, as a main division of the study, 4 ; classification of, 200, 205-6, 211-12 ; collection of: 1023, as at present in Great Britain, 1028, early history of, in France, 1023, in Great Britain, 1023-28 ; distribution of central, provincial and local, determined by historical conditions, 239 ; distribution of, in Australia, 266-267, in Canada, 263-65, in France, 282-84, in Germany, 275-79, in Great Britain, 263, in India, 269-274, in Switzerland, 279, in the Union of South Africa, 267-69, in the United States of America, 279-82 ; financial assistance to Units in Constitutional Acts regarding the distribution of, 288 ; general principles and conclusion regarding the distribution of, in various countries, 284-93 ; in

- Great Britain, 1084 ; in India, 1086-87 ; percentage distribution of, in India and Great Britain, 210 ; ratio of debt to, 1103
- Revenue system, characteristics of a good, 197-99
- Ricardo, David, contribution to public finance, 27 ; on capital levy, 868, on incidence, 340 ; on incidence of a tax on income, 383-384, on rent, wages and profits, 343-46 ; on meeting war expenditure out of loans, 789-90 ; on repayment of debt, 852 ; on taxation of : building rent, 367, capital, 535-36 note, rent, 364, surplus, 591, wages, 380
- Ricca-Salerno, contribution to public finance, 36, 302 ; on characteristics of good tax system, 213
- Richard, M., on octroi, 757
- Richeheu, on education, 114
- Rignano, cited, 36, 529, 540 ; differential rates of, 546 ; scheme of, in regard to graduation according to time, 545, basis of, 542 ; theory of, 547 note ; variations of the plan, 550
- Riksbank, 1057
- Riksdag, 1057
- Roads, keeping of, 721-22
- Robinson, on tariff reform, 632
- Rogers, Thorold, on public domain, 712 ; on Turgot, 214
- Rome, customs in, 620 ; jugera tax in, 390 ; land tax in, 396-97 ; octroi in, 671 ; poll tax in, 583
- Roosevelt, President, veto power and, 1013
- Roscher, classification of public expenditure by, 88 ; contribution to economic science, 21, 32, 33 ; on characteristics of good tax system, 213 ; on mines, 716
- Rothschild, Lord, on foreign loans, 776
- Rowntree, cited, 692
- Royal assent, 986 note
- Royal Commission, on assessment, 500 ; on double taxation, 321-24 ; on graduation, 484-87 ; on importance of collection at the source, 496 ; on income tax, 446, 484, 486
- Royal Order, 1031
- Rumania, cost of War, 1106 ; debt, growth of, 1098
- Ruskin, division of books by, 40
- Russia, area, population, etc., 1071 ; cost of War, 1106 ; debt, growth of, 1098, repudiation of debt in, 862-63 ; State domains in, 713 ; State-owned central bank in, 1056
- Ryotwari system, land revenue under, in India, 413
- Sa'ad, Arab General, 784
- Sacrifice, aggregate, distribution of taxation and, 308, factors underlying, 308, incomes and, 308
- Sacrifice, equal, bachelor and married man and, 306, J. S. Mill on, 306, quantitative aspect of income and, 306 ; windfalls and, 306
- Sacrifice, proportionate, characteristics of, 309 ; definition of, 294-295, relation to equal sacrifice and classical economists, 309-10
- Safeguards, necessity of, 1015 ; Joint Committee on, 1014-15
- Sales tax, characteristics of : in Australia, 619, in Belgium, 618, in Canada, 618, in France, 616, in Germany, 616, disposition of the proceeds of, in various countries, 615-16, importance of, 260-61 ; objections to, 613-14 ; rates and basis of, 612-13 ; scope of, in various countries, 606, 611-612, statistics of, in various countries, 608-9, statistics showing its importance, 607 ; suitability and productiveness of, 619 ; system of collecting, by affixing stamps, 606-7
- Salt, duty on : in Great Britain, 658, in India, 664 ; monopoly of, 662, 668, 670 ; *per capita* consumption of, in India, 664 ; revenue from, 665, in India, 1086-87
- Salt gabelle, 422, 666 ; main excise tax in China, 668 ; net revenue from, 669
- Samuel, A. M., on the ability of market, 676-77
- Samuel, Sir Herbert, investigations by, regarding burden of debt, 692
- Sanction, as a canon of expenditure, 80-82 ; administrative, 1035 ; technical, 1035
- Saving and Enterprise, effects of death duties on, 541-44
- Saving and Spending, theory of, 65 :

- an important problem, 66 ; effects of, 67 ; public and private compared, 69
- Say, Horace, cited, 34
- Say, Jean Baptiste, contribution to public finance, 35 ; on profits, 374 ; on progressive taxation, 310
- Say, Léon, contribution to public finance, 34 ; on Turgot, 214
- Say, Louis, cited, 34
- Scaccarium, 943
- Schaffle, contribution to public finance, 34 ; on meeting all extraordinary expenditure out of loans, 159
- Schedules of Income tax, in Great Britain, 441-42, 449-54 ; assessment as per, 490-91 ; A and B of, for land tax, 399
- Schanz, contribution to public finance, 34 ; on meeting all extraordinary expenditure out of loans, 159
- Schmoller, Gustav, on induction and deduction, 9
- Scientific and miscellaneous, expenditure on, in India, 1076-77, revenue from, in India, 1086-87
- Scotland, education in, 107-8, 115-116 ; poor relief in, 124
- Scott, cited, 946
- Scott, Sir Walter, cited, 230
- Sea custom duties, earlier in origin, 620
- Seckendorff, cited, 18
- Secondary expenditure, 1076-77
- Seligman, E. R. A., on certainty in taxation, 220 ; on characteristics of special assessments, 219 ; on classification of public revenue, 206 ; on difference between personal and impersonal taxes, 327, on differentiation in rates, 477 ; on diffusion or absorption theory, 346 ; on distribution of taxation, 302, 321 ; on divorce between theory and practice, 30 ; on importance of precision in assessments, 219 ; on meeting war expenditure, 790 ; on tax on corporations, 482 ; on tax on profits, 376 ; on succession duty in the United States of America, 553 ; place of his work in financial literature, 30
- Seringapatam, looting at, 783
- Servia, cost of War, 1106 ; debt, growth of, 1098
- Settlement, land, decision of permanent, by the East India Company, 412 ; future of, 421 ; permanent and temporary, 411 ; survey and basis of, 416 ; thirty years period regarding, 413
- Shah Jahan, cited, 410
- Sheriffs, collection of revenue by, 1024 ; rendering of accounts by, 944
- Sherwell, cited, 692
- Shafting and incidence of taxation, definition of, 336 ; distinguished by the Committee on National Debt and Taxation, 336-37
- Shivaji, plunder by, 783
- Shore, Sir John, on settlement, 411
- Short-term debt, 774
- Shultz, contribution to public finance, 30
- Siam, public debt, 1098
- Sidgwick, on direct and indirect taxation, 208, on inheritance tax, 536
- Sinclair, Sir John, contribution to public finance, 22, 23, 214 ; on public accounts, 940
- Single tax, 330 ; drawbacks of, 332-34
- Sinking fund, 27, 163, 164, 166, 174, 182, 186, 266, 267, 849, 879 ; attachment of, to loans, 891 ; changes effected in, 857-58 ; Committee on National Debt and Taxation on, 857 ; definition of, 854 ; early history of, 855 ; formation of a new, 856, suspension of, 891 ; history of, before 1716, 885-86 ; history of, 1717-1788, 887 ; object underlying Pitt's, 888 ; old, origin of, 855 ; principles in the management of, 859 ; resolution of the House of Commons on, 889 ; results of the examination of the British, 892 ; Sir Robert Walpole's, 886 ; Sir Strafford Northcote's new, 890 ; suspension of, 856 ; table showing national debt charges including, 891
- Site value, incidence of tax on, 393 ; taxation of, as source of local revenue, 739
- Slavery, abolition of, 789
- "Slice" system of graduation, 485
- Smith, Adam, as tutor to Duke of Buccleuch, 19 ; contribution to public finance, 22-23 ; esteem for

- Quesnay, 22 ; on advantages of State banks, 711 ; on ability or faculty theory, 305 ; on the Bank of England, 1051-52 ; on canons of expenditure, 77-83, of taxation, 213-25 ; on capital levy versus taxation, 165 ; on capitation taxes, 587, on classification of public revenue, 200-201 ; on distinction between wages and labour, 379-80 ; on East India Company, 73 ; on education, 107 ; on estate duty, 533 ; on expenditure on defence, 98 ; on fees, 203 ; on functions of the State, 54-55 ; on hoarding, 781-82, on import duties, 623 ; on incidence of a tax on building rent, 367, capital and interest, 372-73, internal trade, 358, land, etc., 339-40, profits, 374 ; on indirect tax, 297 ; on investments, 784-85 ; on law and order, 99-100 ; on meeting war expenditure, 791 ; on political economy, 7 ; on proportional taxation, 309-10, on rent, 312 ; on scope of public expenditure, 71-73 ; on stamp duties, 675 ; on State enterprise, 710-11 ; on taxation of capital, 535 ; remarks of Physiocratic doctrine, 21
- Smith, Vincent, on hoarding, 783
- Smuggling, 221, 632, 668
- Soap, tax on, 659
- Social services, expenditure on, 106-138 ; in India, 1076-77 ; revenue from, in India, 1086-87
- Social welfare, 308
- Solon, four classes of citizens in the time of, 310 ; principle of graduation in the legislation of, 484
- Sonnentzsch, Von, contribution to public finance, 19
- South Africa, Union of, area, population, etc., 1071 ; cost of War, 1106 ; customs duties in, 640-41 ; death duties in, 566-67 ; debt : analysis of, 1102, growth of, 1098, ratio to revenue, 1103 ; distribution of revenue in, 267-68 ; excise in, 661-62 ; expenditure on debt services, 1104 ; income taxed by normal tax, super tax and dividend tax, 461 ; land tax in, 403 ; poll tax in, 585-86 ; post office, revenue from, 721 ; railways in, fiscal results of, 723 ; reserve bank of, 1051, 1063 ; separate railway budget in, 729 ; sources of federal revenue in, 269 ; taxation : before and after the War 1090, direct and indirect, 1097, *per capita*, 1091
- South Australia, tax on unimproved land values in, 401
- Spain, area, population, etc., 1071 ; debt : analysis of, 1102, growth of, 1098, ratio to revenue, 1103 ; excise in, 668 ; expenditure on debt services, 1106 ; inheritance tax in, 581, octroi in, 671-72 ; state domain in, percentage revenue from, 713
- Special assessments compared with fees, 203, 261 ; Seligman on the characteristics of, 203 ; source of local revenue, 743
- Specific duty, 299 ; advantages and disadvantages of, 627-29 ; compared with *ad valorem* duties, 627, 629 ; definition of, 627 ; easy for valuation, 627 ; popularity of, 631
- Spence, cited, 332
- Spencer, cited, 55, 56, 332
- Spending, method of, in Great Britain, 1030-35 ; in India, 1035-36
- Stamp, method of calculation of national income by, 237-38 ; estimates of national income by, 239, 242, 700
- Stamp duties, collection of turnover tax by affixing stamps, 674 ; distinguished from taxes, 674 ; judicial and non-judicial, 675 ; incidence of, 675 ; percentage of, to total revenue in various countries, 673 ; principles in imposing, 680 ; revenue from : in Great Britain, 1084, in India, 1086-87, in other countries, 1097
- Stamp, Sir Josiah, analysis of taxes by, 213 ; contribution to public finance, 31 ; estimate of the yield of capital levy in Great Britain, 872 ; on absolute taxable capacity, 229-30 ; on basis of assessment of income tax, 499 ; on collection of tax at the source, 493 ; on equal sacrifice theory, 307 ; on question of public debt and national wealth, 819 ; on

- reparation payments, 846; on uses of Pareto Law, 509: Report on double taxation by, 321
- Stanhope, Earl, on conversions, 895; on sinking fund, 886
- Star Chamber, 1020
- State borrowing, limits of, 787; peculiarities of, 787-89
- States, classification of, 775; methods of control by, in preventing the investor from using alternative methods of investment, 802
- Stationery and printing, expenditure on, in India, 1076-77; revenue from, in India, 1086-87
- Statistics, relation of, to economics and public finance, 7-8; use of, in incidence of taxes, 350-51
- Stein, Von, contribution to public finance, 32; on meeting extraordinary expenditure out of loans, 159; tax as part of cost of production, 347
- Stores, audit of, 1049
- Stourm, René, contribution to public finance, 35; on British budgetary system, 996; on collection of revenue, 1023; on French fiscal period, 966
- Strachey, Sir John, on Condorcet, 662
- Strachey, Sir Richard, on the distribution of revenue in India, 269
- Straits Settlements, estate duty in, 577
- Strong, Governor, on the formula for controlling prices, 1063-64
- Stuart, Cohen-, contribution to public finance, 39; on distribution of the burden of taxation, 302
- Stuart, Sir James, contribution to public finance, 16, 17, 20-21
- Sub-accountants, duties of, 1040
- Subsidies, early history of, in Great Britain, 829; versus War loans, 828
- Subventions to local authorities, 147, 153, 154, 157, 158, 279, 289, 734, 739
- Succession duty, effect on saving and enterprise, 540-45; main source for death duties in Great Britain, 556; exemptions of, 563; rates in Great Britain, 562
- Suez Canal shares, 52, 168, 207, 722, 1084
- Sugar, tax on, 636
- Sukkur Barrage (India), largest irrigation, 162, 189, 718
- Sully, on the collection of revenue, 1023
- Summary of the work, 10-12
- Sumner, Lord, on the arrangement of properties so as to pay less taxation, 502
- Super tax, graduation by, 465-66, 484
- Superannuation, receipts in aid of, 1086-87
- Supplementary budgets, 969, advantages of, 970; Gladstone on, 971
- Supplementary estimates, Gladstone on, 189, 971; legalisation of, 987; May on, 970
- Supply, Committee of, duties of, 981; powers of, 982
- Surtax, capital and, 538
- Surat, sack of, 783
- Surcharge, in France and India, 520
- Surplus, as a canon of expenditure, 82-83; are profits, 375; taxation of, 590-91
- Sweden, area, population, etc., 1071; debt: analysis of, 1102, growth of, 1098, ratio to revenue, 1103; expenditure on debt services, 1104; land tax in, 407; State-owned central bank in, 1056; succession duty in, 522
- Switzerland, area, population, etc., 1071; capital levy in, 871; debt: growth of, 1098, ratio to revenue, 1103; distribution of revenue in, 279; expenditure on debt services, 1104; inheritance tax in, 581; old-age pension in, 124; post, telegraph, telephones, revenue from, 721; separate railways budget in, 729; taxation: before and after the War, 1090, *per capita*, 1091
- Tacitus, on land tax in Rome, 396; use of the term "parsimony" by, 61
- Taft, President, veto power and, 1013
- Tailleur, Richard le, 946
- Tallies, as receipts, 884, 943 note; abolition of, 944
- Tangorra, contribution to public finance, 36
- Tariff, form of a, 627; kinds of, 637; number of articles in, in Great Britain, 632; principles of new,

- in Great Britain, 633 ; reform of, in Great Britain, 627, 632
- Tasmania, amusement tax in, 684 ; estate duty in, 564
- Taussig, contribution to public finance, 30 ; on American tax, 430 ; on characteristics of a tax, 204
- Tax, absence of *quid pro quo* in, 204 ; compared with fees, prices, and fines, 202-3 ; definition of, 204 ; direct and indirect, *see the terms* ; distribution of, theories of, 304 ; double, *see Double taxation* ; evasion and, 501, Pareto's law in regard to, 508-18 ; on capital and interest, *see Capital*, taxation of ; on commodities, *see Commodity taxes* ; on earned income, *see the term* ; on income, *see Income tax* ; on International trade, *see the term* ; on land, *see Land taxation* ; on monopolies, *see the term* ; on profits, *see Profit tax*, on quasi-rent, *see the term* ; on rent, wages, profits, and interest, *see the terms* ; on unimproved value of land, *see under Unimproved value* ; on wages, *see Wages* ; personal and impersonal, *see Personal* ; revenue, as a main head under the classification of revenue, 211 ; shifting and incidence of, *see Incidence* ; single, *see Single tax*
- Tax finance, versus loan finance, various writers on, 789-92 ; capital and, 792 ; justification of, 792 ; richer classes and, 792 ; war and, 792-93
- Taxable capacity, absolute. *See Absolute taxable capacity*
- Taxable capacity, basis of, 234 ; concept of, 226, real importance in the, 233 ; Dawes Committee's index in measuring the, of Germany, 230-31 ; measurement of : (1) the aggregating income method, 238-39, in Great Britain, 239, (2) the census of production method, 239-41, (3) *per capita* figures for, limited use, 239-48, (4) provincial income and, 257, in Australia, 257, statistics showing the results of these methods, 239-240, 243-44, 246-48, 252, 253, 257, 258 ; psychology of the people and, 235 ; relative, *see Relative taxable capacity*, statistical determination of, 236
- Taxation, burden of, 284 ; absence of proper statistics for, 692 ; ambiguous term, 688 ; broad considerations and conclusions of the, 702 ; Colwyn Committee on, 692 ; definition of, 691 ; difficult problems in comparing the, 703, distribution of direct and indirect taxation as an index of the, 698, statistics showing the result, 698 ; effects of, 689 ; effects and advantages of the enquiry into the, 703-5 ; facts from which the idea of a, arises, 690 ; no definite percentage can be laid down in regard to the, 706-7 ; *per capita* taxation as an index of the, 696, statistics showing the result in various countries, 697 ; percentage of, to national income as an index of the, 699, two methods in, 700, statistics showing the results in various countries, 701 ; points to be considered in comparing the, 703 ; statistics showing selected incomes and the duty paid on them, 693-94 ; three points of the, 688
- Taxation, canons of : (1) equality, 215-18, (2) certainty, 218-20, (3) convenience, 220-21, (4) economy, 221-23, (5) other, 223-24 ; capital and, 480, 537, a mistaken belief, 535, classical economists on, 535-536, estate duty and, 537-41 ; changes in theory and practice of, 302-4 ; degressive, definition of, 294 ; differential, 485-88, least aggregate sacrifice and, 308 ; direct and indirect, 296, 1097 ; distribution of, 294-302 ; double, *see Double Taxation* ; factors underlying the increase in, 788 ; foreigners and, 316 ; graduated, definition of, 294 ; in India, 1086-87, 1096, before and after the War, 1090, burden of taxation and national income, 1094-95, local, 1088, *per capita*, 1091, *per capita*, allowing for prices, 1092 ; local, *see Local Taxation* ; progressive, definition of, 299, 310-311 ; proportional, definition of, 286, classical economists and,

- 308-9 ; property, 560, 738-41, 750 ; real income and, 480 ; severity of, method of calculating in Australia, 257 ; single, 330-34 ; statistics showing the increase in various countries, 696 ; theories of : (1) ability or faculty, 305-6, (2) equality of sacrifice, 306-7, (3) minimum or least aggregate sacrifice, 307-9 ; versus loans, 789, effects and nature of, 792-93 ; windfall, 306, 598, 604
- Tellers, 1018, 1032, abolition of, 944 ; robbery in the office of, 946
- Temporary settlement, 413-16
- Tennessee, executive budget in, 957
- Terhalle, contribution to public finance, 34
- Terminal tax, 757
- Thathameda tax, collection of, in Burma, 586
- Theories of just distribution of taxation, 304
- Theory, on national income, 703
- Theresa, Maria, subsidies to, 829
- Thünen, Von, on natural or normal rate of wages, 378
- Tobacco, monopoly of, 666, 667, 669, 850
- Token grants, 1010
- Tolls, 671, 722, 758
- Tonti, inventor of tontines, 774
- Tontines, 774
- Totalisator, tax on, 681-84
- Tour, Roussel de la, contribution to public finance, 23
- Trade and professions, taxation of, as source of local revenue, 738
- Tramways, revenue from, 722
- Transit duty, 620
- Travelling tax, 670
- Treasuries, abolition of, in U.S.A., 1052 ; as custodian of public money in India, 1028-29
- Treasury, causes for the confusion in regard to the functions of Exchequer and, 947-48 ; definition of, 946 ; functions of the, 848 ; lords of the, 947, functions of the, 848 ; part played by the, in the preparation of budget, 951-52, in the spending, 1031-35 ; powers of the, 1040-41 ; two kinds of control by, 1041
- Treasury Chest Fund, advantages of, 1011 ; definition of, 1011 ; simi-
- larity of, to Civil Contingencies Fund, 1011
- Tributes from states, 1086-87
- Tsi, Kuan, creation of salt monopoly by, 668
- Tucker, Josiah, contribution to public finance, 23
- Tunnage and poundage, 621
- Turgot, Adam Smith on, 214 ; as minister, 916, contribution to public finance, 22, 23 : on octroi, 332, on secondary expenditure of government, 140 ; on theory of amortisation, 337
- Turkey, cost of War, 1106 ; debt, 1098
- Turnover tax, 1097. *See* Sales tax
- Twining, contribution to public finance, 23
- Tyler, President, veto power and, 1013
- Tyszka, contribution to public finance, 34
- Umpfenbach, contribution to public finance, 34 ; on meeting extraordinary expenditure out of loans, 159
- Undertakings, government or public, expenditure on, in India, 1076-77, revenue from, in India, 1086-87
- Unearned increment, taxation of, 390 ; distinguished from earned increment and the terms of various countries to, 486, 548 ; four ways of taxing, and their advantages and disadvantages, 392-96
- Unemployment and health insurance : distinction between, and quasi-unemployment, 181 ; in U.S.A., 130 ; increase of, in Great Britain, 178-79 ; relief for, in Great Britain, 129
- Unfunded debt, definition and scope of, 773, 1102
- Unfunded income, 311
- Unimproved value of land, tax on, 401, 403
- Union of South Africa. *See* South Africa
- United Kingdom. *See* Great Britain
- United States of America, accounting office in, 1021 ; appropriation committee in, 1000 ; area, population, etc., 1071 ; Budget and Accounting Act, 958-60 ; budget: contrast before and after 1921

concerning, 960; difference of opinion is solved in conference, 999; early history of a financial plan, 957; initiation of budgetary procedure first by States, 955-56; legalisation of, 998-1001; legislative and executive, in the States, 956; powers of the Chambers regarding, 1009; publications connected with, 975-76; six steps in the preparation of, 960; corporation tax in, 597-98; cost of War, 1106; customs duty in, 646-48; debt: analysis of, 1102; composition of, in 1934, 911; growth of, 1098; history of, 907-13; ratio to revenue, 1103; table showing, 909; "deficiency bills" in, 965; distribution of revenues in, 280-282; excess profits tax in, 603-604; expenditure: and national income, 1083; allowing for prices, 1082; on debt services, 1104; extensive programmes of public works in, 180-81; federal reserve bank, 1052; Board of the Governors of, 1052; general property tax in, 428-29, as source of local revenue and its administration, 738-42; criticism of, 53-54; National Tax Association on, 431-432; importance of local taxation in, 743-44; income tax: Federal, 468; history of, 467; rates and exemptions in, 467-68; states, 469-70; inheritance tax in, 577-579; land tax in, 427 note; loan policy of: in 1917-18, (1) floating of four Liberty Loans, 911-12, (2) use of bank credit, 912, (3) use of terminable annuities, 913, (4) establishment of a sinking fund, 913; octroi in, 671; payments due to, 1105; percentage revenue of direct taxation in, 295; poll tax in, 585; protective tariff in, 646-48; railways in, fiscal results of, 723; sources of revenue for Federal, State and Local authorities, 280-82; statistics showing revenue from gasoline and petrol taxation in, 656; taxation: and national income, 1095; before and after the War, 1090; direct and indirect, 1097; *per capita*, 1091; *per capita*, allowing for prices,

1092; treasury system in keeping public money in, 1021; abolition of, by the Federal Reserve Bank Act of 1913, 1052; unemployment relief in, 130; veto power in, 1012-13; views on capital levy, 876; wealth, 1107
 Unproductive debt, burden of, 811, 814; disadvantages of external, 812-13; effects of internal, 813; results of internal and external, 812; transfer problem and the internal, 815
 Unproductive expenditure, distinguished from productive expenditure, 189-90
 Usher, one of the officers in ancient times in Great Britain, 1018
 Utah, executive budget in, 957
 Uztariz, contribution to public finance, 23
 Value, public, of land, tax on, 390
 Value, unimproved, of land, tax on, 401
 Vansittart, Mr., conversion by, 896; modification of Pitt's sinking fund by, 888
 Vauban, contribution to public finance, 16-17; on poor peasants, 192
 Venice, sovereign's fund in, 200
 Vermont, executive budget in, 959
 Veto power, in various countries, 1012-1013
 Victoria, betting tax in, 682; death duties in, 565
 Victoria, Queen, on estate duty, 558-559
 Voecke, contribution to public finance, 34
 Vuitry, contribution to public finance, 35
 Wages, taxation of, 377; as measure of capacity to pay poll tax in Henry VIII.'s time, 584; historical truth of the theory of, 378; incidence of, 339, 381-83; iron law of, 378; various writers on, 339-45
 Wagner, contribution to public finance, 32; on fees, 202; on good taxes, 213; on increase of value of land, 391; on meeting extraordinary expenditure by loans,

- 159 ; on system of local taxation in Great Britain, 750
 Wakefield, on sale of land in new countries, 714
 Walker, on Smithian canons, 213 note ; on the expression "under the protection of the state," 216
 Walpole, Sir Robert, conversion of debt by, 896 ; on excise, 658-59 ; on tariff, 632 ; sinking fund, 886, 895, 896 ; subsidy by, 829
 Walras, contribution to public finance, 37
 War, constitutional changes after the, 975 ; cost of, 1106 ; effects of, 5, on America, 826 ; expenditure for the preparation of, 96 ; financing of : (1) large amount of foreign loans, 903, (2) consols gave way to war loans (table), 902-3, (3) continuous borrowing, 905, (4) system of tax compounding, 905, (5) floating of debt was high, 905-6 ; net cost of, 779 note ; revenue expenditure for, 160
 War debts, 777-78 ; causes for, 821 ; comparative increase in the amount, 881 ; difference between commercial and, 824 ; economical and financial consequences of, 825-28 ; effects on trade and prices, 821 ; effects of fall in prices on, 826 ; table showing, of various countries, 822 ; unproductiveness of, 821
 War indemnities and reparations, 834
 War loans, beginning of, in the Great War, 830 ; versus subsidies, 828
 War profits tax, 598, 918
 War-time finance, table showing, 901-902
 War-time tax, 1097
 War wealth, levy on, 875
 Warehouse, 658, 661
 Washington, George, association of, with the Great Republic, 715 ; on payment of debt, 828 ; veto power and, 1013
 Ways and Means Committee, 981 ; functions of, 984
 Wealth, classification of, according to origin, 325 ; estimates of, 807 ; of various countries, 1107 ; production of, 544
 Weimar constitution, 955
 Wellesley, Governor of India, on finance ministers, 950
 Wellington, maxim of high interest, 755
 Westland, Sir James, introduction of Excise Duty Bill by, 664 ; re-imposition of duties by, 642
 Wholesale prices, index numbers of, 1090
 Wicksell, contribution to public finance, 40
 William, the porter, 945
 Wilson, President, veto power and, 1013
 Wilson, Right Honourable James, cited, 950 ; increase of duties by, 642 ; introduction of income tax in India in 1860 by, 462 ; on finance, 8
 Wilson law in U.S.A., 647
 Windfall, 306, 598 ; elastic source of revenue, 604
 Window tax, 282, 588 note, 590, 591
 Wisconsin, budgetary procedure in, 956
 Works, public, a policy of controlled, and its pros and cons, 183-84 ; Gladstonian theory of, 171 ; growth of, by local authorities, 172 ; nature and scope of, 168-170
 Yanzhul, contribution to public finance, 40
 Young, Arthur, on motives of industry, 119
 Young industry, protective duties and, 624
 Young loans, 810-11 ; services of, 843-44
 Young plan, 831, 835, 838, 846, 847, 1065 ; weak points of, 841 ; works done by, 841-42
 Zemindari settlement in regard to land in India, 413-14

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